The Balancing Act of Effective Supervision

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The Balancing Act of Effective Supervision:

Understanding the Relationship between Internal and External Supervision

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The Balancing Act of Effective Supervision

Understanding the Relationship between Internal and External Supervision

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TABLE OF CONTENTS

CHAPTER 1

GENERAL INTRODUCTION

"What is the best government? That which teaches us to govern ourselves" – Johann Wolfgang von Goethe, 1833 (Maxim 353)

The above quote illustrates the importance of effective governance for society, including the functioning of its government and business community, and raises the question of what achieving it entails. Specifically, what are the multiple dimensions that comprise such effective governance, and how to strike a balance between internal and external supervision in this regard? The need for effective internal and external supervision to protect societal interests is clearly reflected in the diesel-emission scandal that involved many car manufacturers. The scandal first came to light at Volkswagen in September 2015, when it was revealed that the German car maker – while promoting their 'clean' diesel cars - used software to cover up the emissions of dangerous gases (nitrogen oxide) of their cars that exceeded regulatory requirements (Financial Times, 2016). Many high ranking members of the organization, including the CEO, other top executives, and several senior engineers, were involved in or at least aware of the fraud (Ewing, 2017). As a result, some of those top executives now face years in prison for fraud and stock market manipulation (New York Times, 2019; The Guardian, 2017, 2018, 2019a; U.S. Securities and Exchange Commission, 2019), in addition, the car maker already had to pay 30bn Euros in fines, compensation and legal costs, and is also being sued by half a million German customers (The Independent, 2019; The Guardian, 2019b).

In the case of Volkswagen, the three main responsible parties, the Top Management Team (TMT), and both internal and external supervisory bodies, failed to perform at least part of their responsibilities to safeguard the welfare of the organization and its stakeholders. First of all, the TMT executives, the senior executives including the CEO responsible for strategic decision making, made decisions that prioritized organizational – and their own – short-term interests (profit) over the public's long-term interests (Ewing, 2017). The example also illustrates the failure of internal supervision, as deficiencies in the internal control system allowed the fraud to remain undiscovered (Crête, 2016), and the internal supervisory board failed to perform their supervisory duties and it lacked independence (Environmental Protection Agency, 2016). Moreover, the external supervisory bodies (e.g., the Environmental Protection Agency, EPA), were not able to monitor the impact of emissions on the environment effectively, due to the cheating software and hindrance by Volkswagen of their investigations (Ewing, 2017). Hence, the internal and external supervisory bodies failed or were obstructed to adequately monitor and challenge TMT decision making.

Such failure of internal and external supervisory bodies is particularly problematic for society, as it trusts that these bodies will effectively monitor whether decisions of organizations are sound and protect the long-term interests of all relevant organizational stakeholders, including the general public (Aguilera, Desender, Bednar, & Lee, 2015). Internal supervisory bodies are formally installed by the organization (e.g., supervisory boards, and the compliance function), and these bodies perform such monitoring with all organizational duties and stakeholders in mind (Boivie, Bednar, Aguilera, & Andrus, 2016). External supervisory bodies are officially commissioned by important governmental stakeholders (Lerner & Tetlock, 1999; Tetlock, 1992), and include government inspectorates (e.g., the tax authority), and independent market institutions (e.g., supervisory authorities for the financial sector). These external supervisory bodies, monitor whether decisions of organizations are compliant with the law and safeguard public interests (Wouters & Van Kerckhoven, 2011). Cases like the diesel-emission scandal raise the question of: what makes each supervisory body and the combination of supervisory bodies effective in influencing decision making of TMTs and other groups in organizations? In this dissertation I use an integrative and interdisciplinary approach, with the aim to provide a comprehensive understanding of the multiple dimensions that comprise supervisory effectiveness, by studying the independent *and* the joint impact of internal and external supervision on decisions made by TMTs, middle managers and employees (Aguilera et al., 2015). More specifically, with the empirical studies presented in this dissertation I will provide insight into the following three research questions:

1. How will internal and external supervisory bodies, independently and in relation to each other, impact decision making of these organization members?
2. What psychological mechanisms explain these effects?
3. How do contextual factors impact these relationships?

My dissertation is the result of a combined research project of De Nederlandsche Bank (DNB) and the University of Groningen, funded by DNB, and this combination provided a unique opportunity to link scientific concepts with supervisory practice in my research about the effectiveness and interplay of internal and external supervision in the Dutch financial sector. Consequently, I mostly studied financial organizations with two-tier board structures, as stipulated by the Dutch Financial Supervision Act (Wft), in which internal supervisory boards, as the controlling bodies, are formally and structurally separated from TMTs (i.e., management boards), as the executing bodies responsible for decision making (Maassen, 1999; Mallin, 2007). Hence, I will use the terminology of TMTs and internal supervisory boards relevant to this two-tier board structure throughout this dissertation. It is important to note that, although this particular situation is formally different from one-tier board structures (i.e., where these functions are combined in one management body, the board of directors, with executives and non-executives), the respective division of core tasks of execution and controlling are similar in both board structures (Boivie et al., 2016; Mallin, 2007). Therefore, I believe that my research is also largely applicable to organizations with one-tier board structures. Given the financial sector as specific research context, in the next section I will consider some of the recent developments in this particular industry that are relevant for internal and external supervision.

THE CONTEXT OF THE FINANCIAL SECTOR

The research questions I will examine in this dissertation are especially relevant for the financial sector given its developments over the last decade. The financial crisis (2007-2009) - with its numerous high profile bankruptcies of financial institutions - had a shock effect on the financial sector as a whole and has made the importance of effective internal and external supervision for society highly visible. One of the major contributors to the financial crisis is considered to be a failure of corporate governance, and in particular the ineffective functioning of TMTs, and both internal and external supervisory bodies (Clarke, 2010; Turner, 2009; Kirkpatrick, 2009). Reports also highlight the strained interaction among these parties, such as the lack of critical challenge between internal supervisory boards and their TMTs (Lorsch, 2012), as well as distrust and less openness between these groups and external supervisory bodies (Group of Thirty, 2012; Walker, 2009). To prevent such problems in the financial sector in the future, several specific financial rules were introduced, such as increased bank capital requirements and guidelines to enhance effective governance (Basel Committee on Banking Supervision 2010a,b; 2011). To monitor whether financial organizations comply with these increasing numbers of rules, the intensity of internal and external supervision increased as well. In addition, these supervisory bodies were given more tasks and powers to intervene in case of excessive risk-taking, (near) bankruptcy, and governance failures (Group of Thirty, 2012; Macroeconomic Assessment Group, 2010). Moreover, new international guidelines required more explicit monitoring of behavioral risks in financial organizations and their governance, and such monitoring is expected to be part of the regular risk assessment performed by internal and external supervisory bodies (Financial Stability Board, 2014; Group of Thirty, 2015). At the same time, these supervisory bodies were also urged to consider their relationships with TMTs and each other (Group of Thirty, 2013). Hence, in response to the financial crisis there has been an exceptional focus on enhancing the effectiveness and interplay of internal and external supervision.

The remainder of the introduction is structured as follows. First, I will give a brief overview of the research gaps in current corporate governance literature on the effectiveness and relationship of internal and external supervision in relation to decision making that I will address in this dissertation. Second, I will describe my empirical approach to study the mentioned research questions, and I will outline the different chapters in this dissertation. Finally, I will describe the overall theoretical and practical contributions of my research.

RESEARCH GAPS ADDRESSED IN THIS DISSERTATION

Despite the aforementioned importance attributed to effective internal and external supervision in relation to sound decision making in organizations (e.g., Aguilera et al., 2015), there is only limited theoretical and empirical knowledge about the independent and joint effects of both forms of supervision on decision making by organization members. Corporate governance literature, and especially classic agency theory (Jensen & Meckling, 1976), has been most influential in this regard. Agency theory describes its preferred arrangement of roles between, on the one hand, the TMTs, the top executives (agents) that are responsible for making strategic decisions on behalf of the organization’s shareholders, or owners (principals), and, on the other hand, the internal and external supervisory bodies that monitor these TMT decisions (Fama & Jensen, 1983). In general, agency theorists believe TMTs to be mostly extrinsically motivated, and therefore prone to make short-term decisions focused on their own interests (Eisenhardt, 1989). The best way to counterbalance such self-serving decision biases, in this view, is to make TMTs justify their decisions towards internal and external supervisory bodies (i.e., accountability, Lerner & Tetlock, 1999). Thus, from an agency perspective, supervision by these bodies is believed to safeguard sound TMT decision making that serves the interests of the organization and its shareholders (Jensen & Meckling, 1976).

As a response to agency theory, a fundamentally different perspective was introduced by stewardship theory (e.g., Donaldson, 1990; Donaldson & Davis, 1991), which argues that TMTs are in fact often intrinsically motivated to make sound decisions, with the organizational interests in mind. Moreover, in this view, these aligned interests of internal supervisory boards and TMTs should be reflected in good cooperation between the two parties in service of the organization (Davis, Schoorman, & Donaldson, 1997). From a stewardship perspective, intensive monitoring by any supervisory body is believed to hamper TMTs' felt autonomy of decision making (Davis et al., 1997), and to make TMTs distrust boards' intentions (Frey, 1993). Therefore, such behaviors would undermine the positive intentions of TMTs to make decisions in the best interest of the organization (Corbetta & Salvato, 2004).

Clearly, the two approaches represent different streams within corporate governance literature and have opposing assumptions about the effect of supervision, as agency theory expects a positive effect of supervision whereas stewardship theory is less optimistic about the benefits of such control (Davis et al., 1997; Jensen & Meckling, 1976). Therefore, I will use an interdisciplinary approach throughout this dissertation, which will cover these different streams of literature in corporate governance, combined with the fields of organizational behavior and social psychology. Below, I set out three research gaps that my dissertation will address and thereby will contribute new insights to the above debate between agency and stewardship theory.

The first research gap concerns the fact that the empirical evidence for both theories has mainly considered the *isolated* effects of internal and external supervision on distant organizational-level outcomes, such as financial performance, and not on decision making of TMTs, middle managers and employees directly (Rechner & Dalton, 1991; Tosi, Brownlee, Silva, & Katz, 2003). Moreover, these prior studies demonstrated mixed results for supervision in relation to firm performance (Dalton, Hitt, Certo, & Dalton, 2007), perhaps because such outcomes could also have been influenced by multiple other internal factors and external market contingencies (Desender, Aguilera, Crespi, & García-Cestona, 2013). Additionally, literature in adjacent fields to corporate governance, specifically organizational behavior and social psychology, suggests that organization members probably will react differently to internal and external supervisory bodies and to the combination of both bodies (e.g., Gino, Ayal, & Ariely, 2009; Pennington & Schlenker, 1999). Yet research that compares their respective impact on decision making of different groups of organization members is missing (Aguilera et al., 2015). Furthermore, the exact *nature* of the joint impact of internal and external supervision on decision making is still being debated (Bell, Filatotchev, & Aguilera, 2014; Walsh & Seward, 1990). As governance scholars have argued and found that these different kinds of supervision can either act as substitutes for each other and are mutually exclusive (e.g., Dalton et al., 2007; Desender et al., 2013), or are complementary such that they can compensate for each other's weaknesses (e.g., Milgrom & Roberts, 1992; Tosi, Katz, & Gomez-Mejia, 1997). Hence, literature does not yet provide a full understanding of the independent effects of internal and external supervision in comparison to each other, as well as their relationship in terms of their joint impact on decision making in organizations (Aguilera et al., 2015; Green, Visser, & Tetlock, 2000).

The second research gap relates to the strong emphasis in agency theory as well as in stewardship theory on the role of internal supervisory boards and their monitoring of TMT decisions (Aguilera et al., 2015). From an agency perspective, these boards are believed to be in the best position to control TMT decisions (Boivie et al., 2016; Daily, Dalton, & Cannella, 2003; Jensen & Meckling, 1976), whereas from a stewardship point of view, boards are considered most effective as a strategic partner that provides guidance and advice to TMT decision making (Anderson, Melanson, & Maly, 2007; Sundaramurthy & Lewis, 2003). The focus on internal supervisory boards has yielded fruitful insights, for example, into the challenging circumstances under which these boards have to operate, and their ability to impact organizational-level decision making (e.g., Boivie et al., 2016; Neville, Byron, Post, & Ward, 2018). These outcomes, however, do not provide insight into the relationship between other internal supervisory bodies and decisions of employees, which also impact an organization's ability to achieve its goals and serve all stakeholders' interests (e.g., Kaptein, 2008; Van Riel & Fombrun, 2007). Moreover, these outcomes do not account for the influence of contextual factors in the institutional environment on this relationship, such as collective cultural values (Davidson, Dey, & Smith, 2015). The compliance function is an important internal supervisory body in this regard, as it can influence the daily decisions of employees by directly monitoring their work actions (e.g., Basel Committee for Banking Supervision, 2005), but its actual impact on these decisions is limited (e.g., Treviño, Den Nieuwenboer, Kreiner, & Bishop, 2014). Moreover, it is well established that collective cultural values can influence decision making of employees (Kish-Gephart, Harrison, & Treviño, 2010), yet the evidence for the interactive effect of such values with the presence and activities of the compliance function is inconclusive (e.g., McCabe, Treviño, & Butterfield, 1996; Weaver & Treviño, 1999). Hence, there is a blind spot in current corporate governance research regarding the effectiveness of internal supervision by the compliance function, together with organizational values, in relation to employee decisions.

Finally, over the last decade, studies have examined *structural* governance characteristics of internal and external supervisory bodies in relation to firm performance in an attempt to proxy the behavioral group processes that are generally assumed to enhance TMT decision making (i.e., independent challenge, Boivie et al., 2016; diversity of thinking, De Dreu, 2002; reflexivity West, 2000), but have neglected to study actual psychological processes in this regard (e.g., Westphal & Zajac, 2013). For example, research on characteristics of internal supervisory bodies has focused on the impact of the independence, tenure, and diversity of these bodies (for reviews and a meta-analysis, see Dalton, Daily, Ellstrand, & Johnson, 1998; Johnson, Schnatterly, & Hill, 2013), and for external supervisory bodies, the role of their structural presence, independence, and power was examined (e.g., Barth, Caprio, & Levine, 2004; Barth, Lin, Ma, Seade, & Song, 2013). Moreover, there have been some initial attempts to theoretically understand, how internal and external supervision impact behavioral group processes, such as the relationship between internal supervisory boards and TMTs, and how such processes may explain supervisory bodies' impact on TMT decision making (Halevy, Halali, & Zlatev, 2019; Hambrick, Werder, & Zajac, 2008; Hillman, Nicholson, & Shropshire, 2008). Hence, to date, a direct empirical link between the mentioned structural governance factors, the presumed behavioral group processes and TMT decision making is still missing (e.g., Filatotchev, 2008).

In sum, there are still theoretical and empirical ambiguities regarding the independent and joint influences of internal and external supervisory bodies on decision making of TMTs, middle managers and employees, what psychological processes explain these effects, and how can contextual factors determine these relationships. My dissertation consists of three empirical chapters that together address these research gaps. Specifically, Chapter 2 examines and compares the independent and joint impact of internal and external supervision in relation to decision making of middle managers and employees; Chapter 3 examines how internal supervision by the compliance function and its activities (i.e., compliance programs) affects employees' decisions, in conjunction with the presence of organizational values; Chapter 4 examines the links between internal supervision and structural governance factors, such as the composition of internal supervisory boards, with behavioral group processes, such as intergroup conflict, and TMT decision making, in relation to the role of external supervision.

EMPIRICAL APPROACH AND OVERVIEW OF THIS DISSERTATION

The central goal of my dissertation is to study how, why and when internal and external supervision, independently and together, impact decision making of TMTs, middle managers and employees in organizations. To reach this goal, Chapters 2-4 present the empirical studies I conducted to examine the relationships in the research models depicted in Figures 1.1 and 1.2 (presented in order of the level of analysis). First, Figure 1.1 specifies how internal and external supervision, independently and jointly, are related to team decision making by TMTs (Chapter 4), and Figure 1.2 illustrates these relationships for individual decision making of middle managers and employees (Chapters 2 and 3). Furthermore, the models specify the psychological mechanisms that I expect will explain this impact of internal and external supervision, in particular perceptions of supervisory body power (Chapters 2 and 3) and Board-TMT conflict (Chapter 4). Finally, the research models highlight the contextual factors that I propose will determine these relationships, specifically organizational values (Chapter 3) and structural board composition (Chapter 4). The proposed relationships in both figures will be further explained in the description of the respective chapters below.

The empirical chapters combine different research methods, such as cross-sectional field surveys (Chapters 2 and 3), a scenario study (Chapter 2), and a multi-level field dataset (Chapter 4). For each empirical chapter new data were collected, mostly among members of organizations in the Dutch financial sector, and my samples include subject-matter experts from different hierarchical organizational levels, which either represent an internal supervisory body or are controlled by internal and external supervisory bodies. Furthermore, I will study decision making at the team level as shown in Figure 1.1 (i.e., TMTs), and at the individual level as depicted in Figure 1.2 (i.e., middle managers and employees). The use of multiple sources, research methods, and multiple levels of analyses, is an important strength of my research.

FIGURE 1.1

Research Model for the Independent Impact of and Relationship between Internal and External Supervision in relation to Team-level Decision Making (Chapter 4)

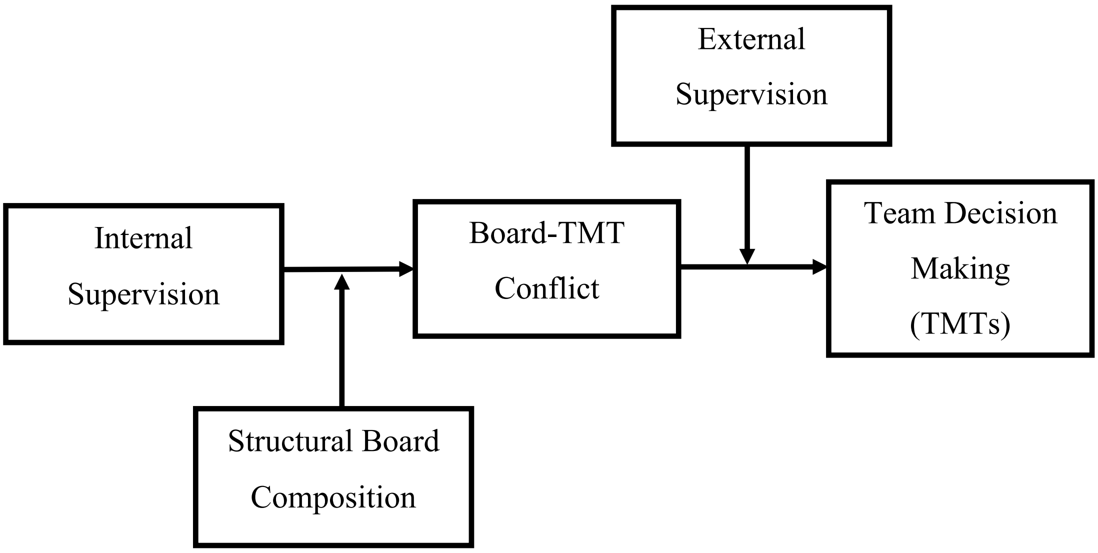
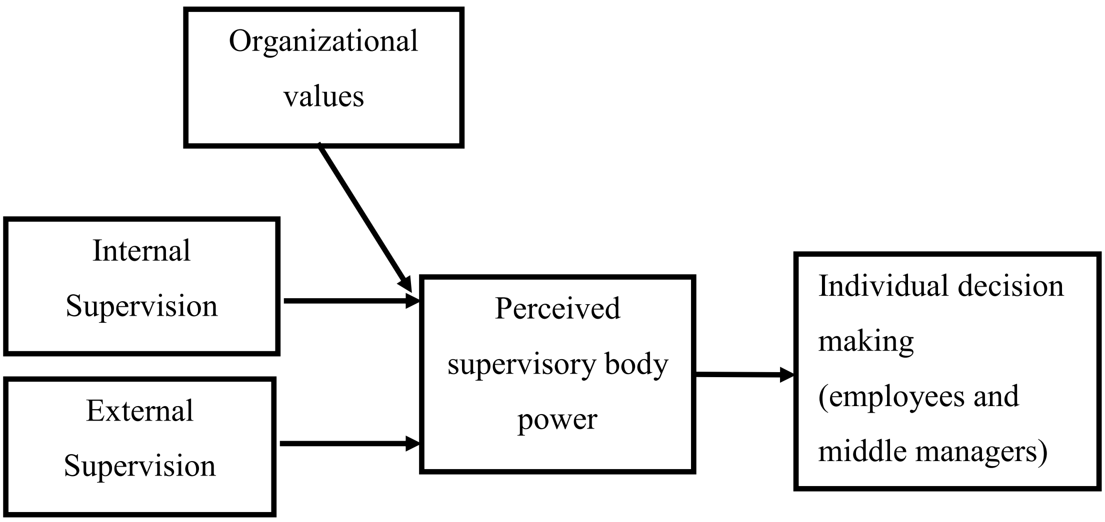


FIGURE 1.2

Research Model for the Independent Impact of and Relationship between Internal and External Supervision in relation to Individual-level Decision Making (Chapters 2 and 3)



Notably, I study internal and external supervision in general terms (i.e., accountability to an internal and external supervisory body; Chapter 2), and I also use specific proxies to measure a variety of internal and external supervisory bodies and their activities (i.e., the compliance function's program of activities, Chapter 3; monitoring by external supervisory bodies for the financial sector, and the internal supervisory board, Chapter 4). I belief that using a wide range of measurements enhances the applicability of my research to a diverse range of organizations. Before I will introduce the three empirical chapters, it is important to note that these chapters are written as independent articles, and therefore there may be some overlap in the theoretical and methodological approaches used.

Chapter 2: The Independent and Joint Impact of Internal and External Supervision

Chapter 2 examines the independent and joint impact of internal and external supervisory bodies on the decisions of middle managers and employees. More specifically, Chapter 2 compares the perceived power for both supervisory bodies (French & Raven, 2001), and examines whether such power explains each body's respective impact on the decisions of these organization members. First, I expect internal supervisory bodies to have a stronger impact on middle managers and employee decisions than external supervisory bodies. As internal supervisory bodies are located inside the organization, they can more frequently and closely monitor organization members than external supervision can (Brass, Butterfield, & Skaggs, 1998; Westphal, 1998).

Moreover, I expect this stronger influence of internal supervisory bodies to be explained by their higher levels of perceived power *over* the decisions of middle managers and employees, as such power will actually motivate these members to change their behavior (Hillman & Dalziel, 2003; Keltner, Gruenfeld, & Anderson, 2003). This power can stem from different kinds of control, or power bases, derived from either supervisory bodies' formal position or their personal characteristics (French & Raven, 2001). Based on social psychology and organizational behavior literature, I argue that internal supervisory bodies are perceived to hold more power because they, unlike external supervisory bodies, represent fellow organizational citizens who organization members can trust (e.g., Gino et al., 2009). Specifically, these bodies have greater access to organizational resources that these members depend upon (i.e., rewards and punishments, e.g., Emerson, 1962), and can engage in more frequent contact and relationships with organization members (Ellemers, De Gilder, & Haslam, 2004). Hence, I argue that internal supervisory bodies are perceived to hold more power than external supervisory bodies do, based on their formal position as well as their personal characteristics (Brass et al., 1998; French & Raven, 2001).

Finally, I will explore the combined presence of both supervisory bodies, and based on the above it can be argued that internal supervisory bodies may already offer such strong behavioral guidelines to organization members, that adding external supervisory bodies could be superfluous (Ellemers, Van Rijswijk, Bruins & De Gilder, 1998).

To test these propositions, I use multiple research methods, namely a field survey, among 418 middle managers and employees of a diverse range of organizations (Study 2.1), and an experimental scenario, among 62 financial middle managers (Study 2.2).

Chapter 3: Internal Supervision and the Role of Organizational Values

Chapter 3 studies how internal supervision by the compliance function impacts employees' decisions, in conjunction with the presence of organizational values. Based on organizational behavior literature, I expect that the presence of the compliance function with its supervisory activities (i.e., compliance programs) and collectively shared organizational values will both signal to employees what is desired behavior in terms of sound decision making (e.g., Kaptein, 2015; Weaver & Treviño, 1999). Moreover, I will explore their joint impact, as organizational behavior theory and research suggests that compliance programs and organizational values will interactively determine employee decisions (e.g., Smith-Crowe, Tenbrunsel, Chan-Serafin, Brief, Umphress, & Joseph, 2015; Weaver & Treviño, 1999).

Furthermore, I expect that compliance programs and organizational values will both achieve the desired behavior that fosters sound decision making (e.g. Weaver & Treviño, 1999), by creating perceptions of internal supervisory power. I also propose that they do so through different power sources or bases, derived from either their formal position or personal characteristics (French & Raven, 2001). Specifically, I expect that compliance programs will create perceptions of compliance officers' power, based on their formal position to monitor and sanction rule violations, which will make organization members refrain from undesired behavior in terms of sound decision making (Kaptein, 2015; Tyler & Blader, 2005). Additionally, I propose that organizational values will signal power of compliance officers based on their personal characteristics, because such officers provide organization members with informal guidance to understand the common social norms (e.g., Van Knippenberg, 2011). Consequently, these members will display desired behavior and make more sound decisions (Pagliaro, Ellemers, & Barreto, 2011).

To examine these predictions, I conduct a field survey among 78 compliance officers.

Chapter 4: Internal and External Supervision and the Role of Structural Board Composition and Board-TMT Conflict

Chapter 4 examines the link between internal supervision and board composition, as structural governance factor, with intergroup conflict, as behavioral group process, and TMT decision making, in relation to the role of external supervision. First, I predict that frequent internal supervision is related to conflict between internal supervisory boards and their TMTs (Board-TMT conflict). Identity literature (Tajfel & Turner, 1979), suggests that frequent internal supervision by boards of TMT decisions may be perceived as criticism of a TMT's group identity that they are keen to protect (i.e., their collective image and the values they stand for as a group; Tajfel & Turner, 1986). As a result, such criticism can emphasize pre-existing relational tensions between both groups (Brewer, 2001), or disrupt relatively good interpersonal relationships (Davis et al., 1997). Research indeed shows that frequent internal supervision may result in higher conflict between internal supervisory boards and TMTs (Eddleston & Kellermanns, 2007; Falk & Kosfeld, 2006).

Moreover, based on social psychology literature, I expect that the composition of the internal supervisory board in terms of tenure, and particularly the degree to which new members have entered the board recently, will reduce the likelihood of such conflict between internal supervisory boards and TMTs (e.g., Hogg, 1992; Pelled & Adler, 1994; Haslam & Ellemers, 2005). This reasoning is in line with research showing the impact of groups' composition on their attitude towards other groups (e.g., Dunbar, Saiz, Stella, & Saez, 2000; Petersen, Dietz, & Frey, 2004), and especially groups with newly joint members are more likely to have constructive relationships with other groups (Schwartz, Struch, & Bilsky, 1990).

I further argue that if such Board-TMT conflict does arise, it can harm TMT decision making, because it will make TMTs more focused on processing information in their own favor, instead of information that may harm their positive self-image (e.g., Knapp, Dalziel, & Lewis, 2011; Staw, Sandelands, & Dutton, 1981). Research shows that such conflict indeed tends to harm team functioning, including the decision-making abilities of TMTs (e.g., De Wit, Greer, & Jehn, 2012). However, I expect that increased external supervisory monitoring or the intervention by an independent third party with legitimate authority can prevent harm to TMT decision making (e.g., Jehn & Bendersky, 2003). Research demonstrates the ability of third parties with such intervention authority, like external supervisory bodies, to suppress the negative effect of conflict between other parties (Keashley & Newberry, 1995).

To test these predictions, I use a multi-source field dataset on the team-level among 111 TMT members and 152 members of internal supervisory boards from 56 Dutch insurance companies.

Chapter 5: General Discussion

In Chapter 5, the general discussion, I will discuss the main findings presented in the three empirical chapters (2-4), and I will reflect on the findings in light of the three research questions and their specific contributions to corporate governance literature. I will further discuss the strengths and limitations of the research approach that I used, and I will propose avenues for future research. Finally, I will reflect on the practical implications of my research for organizations, supervisory bodies, and policymakers to enhance the effectiveness of internal and external supervision and their relationship in relation to sound organizational decision making.

THEORETICAL AND PRACTICAL CONTRIBUTIONS

Overall, the empirical research presented in this dissertation contributes to corporate governance literature, by enriching this body of work with insights based on organizational behavior and social psychology literature. This interdisciplinary and integrative approach was key to gain a comprehensive understanding of the multiple dimensions that comprise supervisory effectiveness, by studying the unique influence ánd the interplay between internal and external supervision in relation to decision making of TMTs, middle managers and employees in organizations (Aguilera et al. 2015; Pennington & Schlenker, 1999). In doing so, my dissertation contributes to the earlier identified gaps in current corporate governance research. First, my research goes beyond studying the isolated effects of internal and external supervision, and includes more direct measures of decision making than the usual proxies used in prior research regarding financial performance (e.g., Tosi et al., 2003). In addition, by examining the role of psychological mechanisms, such as perceived power perceptions of supervisory bodies and intergroup Board-TMT conflict, my research adds insight to *why* internal and external supervision, also in combination, have a certain impact on decision making. Moreover, by including contextual factors on the team and organizational level, such as structural governance factors (board composition) and organizational values, my research creates insight into boundary conditions determining *when* internal and external supervision, independently and together, impact decision making (Filatotchev, 2008).

This dissertation also makes several practical contributions. First, by studying samples of organization members from the top executive level and the lower organization level (LeBlanc & Schwartz, 2007), my research provides insights into the effectiveness and relationship between internal and external supervisory bodies in real-life organizations. Second, as was illustrated by the Volkswagen example, effective internal and external supervision are *both* crucial in safeguarding sound decision making that protects the interests of all organizational stakeholders, including the public interest. In this respect, my research provides practical insights regarding the independent and joint effects of internal and external supervision on decision making in organizations, and under which circumstances and why different kinds of supervision are effective. These insights can be used to design tailor-made approaches for an organization's specific context, to improve the effectiveness of internal and external supervision, and to optimize their relationship to safeguard sound decision making.

CHAPTER 2

HOW INTERNAL AND EXTERNAL SUPERVISORY BODIES IMPACT ORGANIZATION MEMBERS' SELF-SERVING DECISIONS[1]

ABSTRACT

This chapter examines the independent and joint impact of internal and external supervisory bodies in relation to self-serving decisions of organization members (i.e., middle managers and employees). We propose that internal supervisory bodies will have more impact on these decisions than external supervisory bodies, because they are believed to hold more power over organization members, based on their formal position (i.e., position power) and personal characteristics (i.e., personal power). The results of a field survey among 418 organization members (Study 2.1), and a scenario study among 62 organization members (Study 2.2) largely confirm these predictions. The presence of internal supervisory bodies was indeed more strongly negatively related to participants' self-serving decisions than the presence of external supervisory bodies. This stronger relationship for internal supervisory bodies was explained by their higher perceived power, and especially position power, but not their personal power or proximity. The findings further suggest that the presence of both supervisory bodies did not automatically provide additive value. These findings advance knowledge on the relative and combined impact of both supervisory bodies, with power as psychological mechanism, on sound decision making in organizations.

[1]This chapter is based on De Waal, M.M., Rink, F.A., & Stoker, J.I. (2015), published as part of the DNB working series (no. 464), How internal and external supervisors influence employees' self-serving decisions. The paper was presented at the 75th conference of the Academy of Management (2015) in Vancouver, Canada, and its abstract is included in the Academy of Management proceedings (Vol. 2015, No.1).

A number of financial scandals have shown that organization members (i.e., middle managers and employees) can make self-serving decisions that are destructive and not in the interests of the organization or the larger society (De Cremer & Van Knippenberg, 2004; Howell & Shamir, 2005). The Libor case in 2012, for example, revealed that in as many as twenty banks, organization members had manipulated the most commonly used interest rate used for selling financial products to personally profit from trades (i.e., the Libor rate; Financial Times, 2013). This is a classic situation that implies moral hazard that can easily lead to self-serving decisions, such that it allows organization members to maximize their own utility to the detriment of their organization and its customers (Kotowitz, 2008). The Labor rate has a direct impact on the prices that customers pay for loans and influences the interest customers receive on their savings, and therefore the Libor case raised a fierce public debate on how these banks can restore societies' trust in financial personnel.

In order to prevent organization members from making such self-serving decisions, many organizations appoint internal supervisory bodies, such as internal supervisory boards or audit committees, to lay down rules for proper practices (i.e., codes of conduct; Treviño, Den Nieuwenboer, Kreiner, & Bishop, 2014), and to control whether work actions are in the interest of the organization. After the financial crisis (2007-2009) the main public response was to further strengthen the position of *external* supervisory bodies, such as tax authorities, accountants and formal governmental or independent supervisory agencies, which are responsible for safeguarding the stability of the industry, and as such, also supervise the risks that organizations pose to their customers and the public interest (Wouters & Van Kerckhoven, 2011). Advocates of this public response assume that organization members will be sufficiently aware that their organization has to justify its decisions to external supervisory bodies, and will make more sound decisions accordingly. It remains to be investigated, however, whether internal and external supervisory bodies are indeed both effective in reducing organization members' self-serving decisions on a day-to-day basis. The current research therefore sets out to answer this question, by examining the relationships of internal and external supervision independently, and explore their relationship with regard to organization members' self-serving decisions.

The research presented in this chapter contributes to existing corporate governance and organizational behavior literature in two important ways. First, corporate governance literature demonstrates that external supervisory bodies have a significant role in controlling organizational actions and, in this capacity, influence organizational outcomes and individual CEO decisions (e.g., Barth, Caprio, & Levine, 2004; Laeven & Levine, 2009; Westphal, 1998). However, this area of research has not yet directly examined whether external supervisory bodies also have a direct impact on the daily work decisions of organization members operating at lower levels within the organization (Hambrick, Werder, & Zajac, 2008). Research in organizational behavior did examine this question (Barreto & Ellemers, 2000; Smith & Louis, 2009), and suggests that internal supervisory bodies, which can monitor the everyday activities of organization members directly, should be particularly effective in reducing their self-serving decisions (Brass, Butterfield, & Skaggs, 1998). Although these different theoretical developments reflect the topic's relevance across multiple disciplines, they also indicate that research to date has examined the effectiveness of each supervisory body only in isolation and at different levels of analyses (i.e., organizational and CEO level vs. individual organization member level). By conjointly examining the impact of internal and external supervisory bodies on organization members' self-serving decisions, the present research aims to integrate the two streams of literature to offer a broader, more conclusive viewpoint on this matter. Such an integrative approach will help to more fully understand the independent and combined impact of internal and external supervision in relation to individual organization members' decisions (e.g., Aguilera, Desender, Bednar, & Lee, 2015).

Second, in this chapter we also examine *why* organization members are affected by internal and external supervisory bodies. We propose that organization members' dependency on a supervisory body (in terms of receiving resources or getting punished) drive their motivation to make self-serving decisions (Emerson, 1962). Knowledge on this underlying process is critical as it will provide valuable insights into the psychological foundations of organizational members' behavior and informs society why certain sources of control, or power bases, relate to individual organization members' decisions more strongly than others.

THEORETICAL FRAMEWORK

The Role of Supervision

The work decisions organization members make often reflect judgments that are motivated by their own self-interest, even when they seem indefensible to others. Such self-serving decisions tend to be caused by general psychological biases, such as people's tendency to process information in manners that support their pre-existing views (i.e., self-serving bias, Haidt, 2001). However, organizational forces, like certain incentives or work structures, can also persuade organization members to make decisions that maximize their own utility (Dowd, 2009).

Given that organization members' self-serving decisions tend to be detrimental to their organization and often also harm the larger society (Pitesa & Thau, 2013), there is general agreement among practitioners, policy makers and scientists that their actions should be supervised closely. Supervisory bodies execute this supervision process; they are formally installed to hold organization members accountable for their decisions (Bovens, 2005; Frink & Klimoski, 1998). Supervisory bodies thus require organization members to explain their activities in a transparent manner and to justify their conduct (Lerner & Tetlock, 1999).

There is abundant empirical evidence that organization members indeed make less self-serving decisions when they are held accountable for their behavior (De Cremer & Bakker, 2003; De Cremer, Snyder, & DeWitte, 2001; Kerr, 1999). Given that people have a basic human need to get approval from others (Baumeister & Leary, 1995), they tend to experience self-presentational concerns to perform well when their behavior is being monitored (Baumeister & Hutton, 1987). Nonetheless, supervisory bodies do not always establish desirable effects. For example, some studies show that organization members who have to justify their decisions to a supervisory body can also become relatively strategic in their actions; they merely depict a more positive image of their accomplishments, but do not change their behavior substantially (Frink & Ferris, 1998; Lerner & Tetlock, 1999).

Some scholars have argued that the effectiveness of supervisory bodies is contingent on the *kind* of behaviors that they hold organization members accountable for (Frink & Klimoski, 1998; Lerner & Tetlock, 1999). There are studies demonstrating that organization members make significantly less self-serving decisions when they have to justify the process to reach their work decisions (i.e., procedural accountability), than when they only have to account for the quality of those outcomes (i.e., outcome accountability; Siegel-Jacobs & Yates, 1996). So, when organization members are held accountable for how they make their decisions, they make a more even-handed evaluation of decision alternatives (Pitesa & Thau, 2013). Other scholars have proposed that the effectiveness of supervision may also depend on *who* is supervising organization members (Frink & Klimoski, 2004; Pennington & Schenkler, 1999). Organization members often have to justify their actions to external supervisory bodies outside their organization (Abelman, Elmore, Even, Kenyon, & Marshall, 1999), and/or to internal supervisory bodies inside their organization (Frink & Klimoski, 2004). However, it remains to be investigated which type of supervisory body will most effectively reduce the likelihood that organization members make self-serving decisions, and why these supervisory bodies have this influence.

The Power of Supervisory Bodies

External and internal supervisory bodies both control important resources upon which organizations and their members depend (Brass et al., 1998; Frink & Klimoski, 1998;

Milgram, 1963). External supervisory bodies, such as tax authorities, accountants, and formal governmental or independent supervisory agencies, are often commissioned by important governmental stakeholders (Lerner & Tetlock, 1999; Tetlock, 1992), and have legitimate authority to sanction organizational operations (Adams & Ferreira, 2012), to change organizational and incentive structures, and ultimately to replace top managers (Barth et al., 2004). Studies in the corporate governance domain demonstrate that external supervisory bodies therefore tend to reduce negative organizational outcomes, such as organizational risk-taking (e.g., Laeven & Levine, 2009), and enhance a collective focus among organizations' CEOs (Westphal, 1998).

Internal supervisory bodies are also installed by important organizational stakeholders and can control organizational operations, incentive policies and managerial positions (Finkelstein, 1992; John & Senbet, 1998). Organizational behavior literature argues that, because of this position, internal supervisory bodies, unlike external supervisory bodies, can engage in frequent contact with organization members, and thus build personal relationships with them (Ellemers, De Gilder, & Haslam, 2004). According to this reasoning, external supervisory bodies might be less effective in influencing the everyday decisions of lower-level organization members than internal supervisory bodies. Empirical research in this area indeed shows that most organization members, because they feel committed to their organization and to those members who represent it (Ellemers, Van Rijswijk, Bruins, & De Gilder, 1998), are influenced more strongly by the opinions of organizational members than by the opinions of outsiders (Brass et al., 1998; Gino, Ayal, & Ariely, 2009).

More importantly, because of their unique position within an organization, internal supervisory bodies have more specific options to sanction or reward organization members' daily work activities than external supervisory bodies have (Brass et al., 1998; French & Raven, 2001). This notion is based on studies demonstrating that organization members feel highly dependent on internal supervisory bodies for gaining certain organizational resources, such as promotions or incentives (Hillman & Dalziel, 2003). Accordingly, there is reason to believe that internal supervisory bodies may be perceived to hold more power over organization members than external supervisory bodies do, as the latter can only monitor them indirectly and infrequently (e.g., Brass et al., 1998; Foucault, 1982; Haslam, 2004). We therefore present the following three hypotheses:

Hypothesis 1: The presence of internal supervisory bodies is more strongly negatively related to organization members' self-serving decisions than the presence of external supervisory bodies.

Hypothesis 2: Internal supervisory bodies are perceived to hold more power over organization members than external supervisory bodies do.

Hypothesis 3: Internal supervisory bodies' perceived power level will mediate the relationship of their presence with organization members' self-serving decisions.

Note that we do not hypothesize that external supervisory bodies are not related to organization members' decision making at all. As said, external supervisory bodies do have legitimate authority, to sanction organization members' self-serving decisions if it harms the organizational or societal interest, so they should influence organization members' work actions at least to some extent. We merely expect that organization members perceive internal supervisory bodies to be more powerful, and hence are more strongly negatively related to their self-serving decisions, than external supervisory bodies.

Finally, since organizations and policy makers can of course (and often do) present organization members with both internal and external supervisory bodies (Walsh & Seward, 1990), we will also examine their interactive relationship with organization members' self-serving decisions. We did this for explorative reasons as to date, little is known about the effects of the combined presence of both bodies (Green, Visser, & Tetlock, 2000). On the one hand, corporate governance scholars argue that a combination of both supervisory bodies should have an additive effect and thus will be most effective in reducing organization members' self-serving decisions, because they can then compensate for each other's weaknesses (Adams & Ferreira, 2012; Walsh & Seward, 1990). On the other hand, however, organizational behavior literature suggests that internal supervisory bodies, with their relatively high levels of power, may already offer such strong behavioral guidelines to organization members that the combination with external supervisory bodies may have little additive value (Ellemers et al., 1998).

Overview of Studies

The goal of the presented research in this chapter is to examine how the presence of internal and external supervisory bodies, independently and together, are related to the self-serving decisions of organization members (i.e., middle managers and employees) in daily practice. We executed two studies to test our predictions. The first cross-sectional study (Study 2.1) was conducted among a large sample of organization members, 418 middle managers and employees, to get initial insights into the extent to which these members recognize that they have to justify their work actions to internal and external supervisory bodies. This study further assessed to what degree organization members perceive that both supervisory bodies hold power over them, and demonstrate a tendency to adapt their self-serving decisions accordingly. Study 2.1 thus allowed us to observe the natural relationships between organization members' decisions and the presence of internal and external supervisory bodies, without interference of specific organizational or task conditions.

Study 2.2 was conducted among 62 financial middle managers and used a scenario methodology to confirm the causal direction of our predicted relationships. Moreover, by using an experimental design, we could also make a more systematic comparison of the independent and combined relationships of internal and external supervisory bodies with organization members and also of the possible power bases of the two supervisory bodies. The financial managers were asked to solve an investment dilemma in which they had to choose between their own personal interests and the organization's interests (i.e., self-serving decisions; Komorita & Parks, 1994). They were informed that their decision would be controlled by either an internal or external supervisory body, or by both supervisory bodies.

STUDY 2.1

Method

Procedure and Sample. The study was part of a large-scale research questionnaire presented to readers of *Intermediair*, a Dutch weekly magazine aimed at highly-educated professionals. In total, 473 respondents participated voluntarily in the questionnaire online in return for participating in a book-token raffle. However, 55 respondents were excluded a priori from this sample due to incomplete responses. This yielded a final sample of 418 respondents (247 men, 171 women, M_{age} = 43.4 years). Half of these respondents held a middle management position (50%). In terms of education, 43% had a Bachelor, 41% a Master, and 9% a Post doctorate degree or similar. In terms of economic sector, 22% worked in industry, 33% worked in trade and commercial services, 30% worked in non-commercial services, and 15% worked in other sectors.

Measures

Presence of internal and external supervisory bodies. Organization members' awareness of the presence of internal supervisory bodies and external supervisory bodies was measured with two single items (Frink & Ferris, 1998): "I am held accountable for my work by the top management *within* my organization" and "I am held accountable for my work by a party *outside* of the organization". These items were assessed on a 7-point Likert scale ranging from 1 ("*totally disagree")* to 7 ("*totally agree"*).

Self-serving decision. Organization members' tendency to make self-serving decisions was measured with one dichotomous item; "When I experience conflict between my personal interests and the organization's interests at work, I tend to choose; (0) the organization's interests or (1) my personal interests". Accordingly, a higher score on this measure refers to more self-serving decisions.

Perceived power. The extent to which organization members perceived each supervisory body to hold power over them was measured with scales consisting of two items each (Lammers, Stoker, & Stapel, 2009). For internal supervisory bodies, the items were: "To what degree do you think that top management has power in your organization" and "To what degree do you think that top management has influence in your organization". Together, these items represented a reliable scale (r = .82, p < .001). For external supervisory bodies, the items were: "To what degree do you think that external parties, such as external supervisory bodies, have power in your organization?" and "To what degree do you think that external parties, such as external supervisory bodies, have influence in your organization?" These items also represented a reliable scale (r = .83, p < .001). All questions were assessed on a 7-point Likert scale ranging from 1 ("*totally disagree")* to 7 ("*totally agree"*).

Control variables. Past research has emphasized the critical role of having management experience (i.e., in a middle management position or equivalent) within the organization, for how often organization members have contact with, and respond to, supervisory bodies (e.g., Mulgan, 2000). We therefore included this organization member characteristic as control variable in our analyses (0 = no management experience, 1= management experience).

Results

Descriptive statistics. Table 2.1 presents the means, standard deviations, and Pearson zero-order correlations for all Study 2.1 variables and control variable. This table shows that there was a negative correlation between management experience and organization members' self-serving decisions[2]. Interestingly, organization members' awareness of the presence of internal supervisory bodies was uncorrelated with their awareness of the presence of external supervisory bodies, suggesting that the presence of the two supervisory bodies are indeed believed to be distinct from each other. Table 2.1 further shows that the presence of internal supervisory bodies was negatively correlated with organization members' self-serving decisions, whereas the presence of external supervisory bodies was not.

TABLE 2.1

Descriptive Statistics and Correlations among Variables and Control Variable in Study 2.1

Variables	**Mean**	**SD**	**1.**	**2.**	**3.**	**4.**	**5.**	**6.**
1. Management experience	1.50	0.50						
2. Self-serving decisions	0.16	.16	-.14**					
3. Presence internal supervisory bodies	4.81	1.59	.12*	-.10*				
4. Presence external supervisory bodies	2.90	1.86	-.04	.08	.08			
5. Power internal supervisory bodies	5.31	1.33	.01	-.12*	.25**	-.03		
6. Power external supervisory bodies	4.17	1.65	-.11*	.08	.07	.29**	.14**	

N = 418 (listwise) * $p < .05$, ** $p < .01$ (two-tailed)

Statistical analyses. To test Hypothesis 1 and 2, we standardized all independent variables following Aiken and West (1991) and conducted multiple logistic regression analyses. In all analyses, we first entered the control variable in step 1, and then the presence of internal supervisory bodies and the presence of external supervisory bodies as our main independent predictors in step 2, and their interaction term in step 3. For Hypothesis 2 we

[2] Given this significant correlation we further examined the impact of management experience, and these exploratory analyses did not change the main result presented here. Interestingly, it did provide an additional insight that organization members in management positions perceived internal supervisory bodies to be most powerful, we will discuss this result in relation to the design of Study 2.2 (for more detailed results, see the Appendix).

conducted two separate regression analyses, one to predict the perceived power of internal supervisory bodies and one to predict the perceived power of external supervisory bodies. To test our mediation as proposed in Hypothesis 3, we first conducted another logistic regression analysis to examine whether the perceived power levels of both supervisory bodies predicted organization members' self-serving decisions. Subsequently, we performed a SPSS process macro that provides the bias-corrected and accelerated bootstrap confidence intervals for mediational relationships (Hayes, 2012).

Hypotheses testing. Hypothesis 1 proposed that the presence of internal supervisory bodies is more strongly negatively related to organization members' self-serving decisions than external supervisory bodies. Our results revealed that there was a significant and negative direct relationship between the presence of internal supervisory bodies and organization members' self-serving decisions ($B = -.25$, $p = .05$, $R^2 = .06$), whereas we found no significant relationship for the presence of external supervisory bodies ($B = .25$, $p = .07$, $R^2 = .06$). Moreover, we found no significant interaction of the combined presence of internal and external supervisory bodies in relation to organization members' self-serving decisions ($B = .08$, $p = .52$, $R^2 = .06$), and this suggests that there may be no additive value in combining both supervisory bodies. Together, these findings suggest that the presence of internal supervisory bodies may indeed be more strongly negatively related to organization members' self-serving decisions than the presence of external supervisory bodies.

Hypothesis 2 proposed that internal supervisory bodies are perceived to hold more power over organization members than external supervisory bodies do. The regression results with regard to the perceived power of internal supervisory bodies revealed that their power was predicted only by the awareness of organization members that internal supervisory bodies were present ($B = .35$, $p = .00$, $R^2 = .06$). There was no significant direct relationship between the presence of external supervisory bodies with the perceived power of internal supervisory bodies ($B = -.06$, $p = .31$, $R^2 = .06$), and we also found no significant interaction of the combined presence of both bodies (B = -.05, p = .36, R^2 = .06). Moreover, the results for the regression on external supervisory bodies power largely showed a similar pattern of results; their power level was also only predicted by organization members' awareness of their presence (B = .46, p = .001, R^2 = .09), and not by the presence of internal supervisory bodies (B = .10, p = .20, R^2 = .09). In this case, however, we did find a significant interaction of the combined presence of both bodies in relation to the perceived power of external supervisory bodies (B = .20, p = .01, R^2 = .10). This latter result suggests that external supervisory bodies were perceived to be most powerful when organization members were aware of the presence of both external *and* internal supervisory bodies.

To make a more direct comparison between the perceived power levels of both supervisory bodies, we conducted a paired samples t test. The results showed that on average the perceived power level of internal supervisory bodies (M = 5.32, SD = 1.33) was significantly higher than the perceived power level of external supervisory bodies (M = 4.14, SD = 1.64), t(417) = 12.36, p = .00, d = 1.18. Hence, the results further support Hypothesis 2.

Hypothesis 3 proposed that internal supervisory bodies' power level will mediate the relationship with organization members' self-serving decisions. Consistently, our results show that only the perceived power of internal supervisory bodies had a significant relationship with organization members' self-serving decisions (B = -.36, p = .01, R^2 = .07; perceived power of external supervisory bodies; B = .26, p = .08, R^2 = .07). The mediation analysis confirmed that the direct relationship between the presence of internal supervisory bodies and organization members' decisions became insignificant (B = -.16, p = .23), while the indirect relationship through internal supervisory bodies' perceived power became significant (B = -.07, SE = .04, p = .04, R^2 = .06; CI 95%= -.1596, -.0055, 5000 re-samples).

Discussion

The findings from Study 2.1 provide initial evidence for our Hypotheses 1-3. As predicted, the presence of internal supervisory bodies was more strongly and negatively related to organization members' self-serving decisions than the presence of external supervisory bodies. This stronger relationship can be explained by the higher power of internal supervisory bodies perceived by organization members compared to external supervisory bodies. So, even though organization members granted power to both supervisory bodies when they were aware of their presence, organization members' self-serving decisions were more impacted by the power of internal supervisory bodies. Interestingly, we found no significant relationship for the combined presence of both bodies with organization members' self-serving decisions. This result tentatively suggests that there may be no automatic additive value in the combination of internal and external supervisory bodies.

An important strength of this first study is that we collected data among a large working population from real-life organizations operating in diverse business sectors. We therefore feel confident that our findings reflect natural relationships that extend to a broad range of organization members working across different organizational contexts. However, as Study 2.1 was cross-sectional in nature, we could not make causal inferences based on these results, or use different measurement methods to assess our constructs (Podsakoff, MacKenzie, Lee, & Podsakoff, 2003). To address these limitations, we conducted a second experimental study among financial managers, in which we manipulated the presence of internal and external supervisory bodies, independently and in combination, and subsequently asked these financial managers to make a hypothetical investment decision with possible personal gain (i.e., potential self-serving decision).

STUDY 2.2

In addition to testing the causal direction of our proposed relationships, there were a few other reasons why we designed Study 2.2. First, as we cannot draw firm conclusions how the presence of both supervisory bodies impacts organization members' decisions on the basis of the results obtained in Study 2.1, we decided to examine the combination of internal and external supervisory bodies again in Study 2.2. The use of an experimental design allowed us to make a more systematic comparison between the independent and combined presence of the two supervisory bodies.

Second, the results from Study 2.1 were in line with our predictions as they suggest that external supervisory bodies are less influential than internal supervisory bodies. However, we found that external supervisory bodies did not have *any* significant relation with organization members' decisions. We consider it unlikely that external supervisory bodies are completely incapable of motivating organization members' behavior. After all, external supervisory bodies represent quasi-legal institutions that can use formal powers, to control organizational activities and organization members (Wouters & Kerckhoven, 2011). So, perhaps external supervisory bodies did not have a strong relationship with organization members' self-serving decisions in Study 2.1, because we did not sufficiently capture this particular power base. In Study 2.2, we thus examined whether organization members recognize what exact sources of control of organizational resources, or power bases, internal and external supervisory bodies hold over them, and also how the dependency on the related resources shapes the motivation of organization members to make self-serving decisions (e.g., Brass et al., 1998).

In light of the above, literature makes a distinction between two relevant sources of control, or power bases, namely position power and personal power (Yukl & Falbe, 1991). Position power stems from a formal division of roles, whereas personal power is based on personal characteristics of the power holder (French & Raven, 2001). As mentioned earlier, external supervisory bodies are formally commissioned by important governmental stakeholders to control organization operations (Lerner & Tetlock, 1999; Tetlock, 1992). Research therefore suggests that external supervisory bodies may hold some perceived position power over organization members, as they are found to have legitimate authority to sanction and reward organizational actions (Barth et al., 2004). It is assumed, however, that internal supervisory bodies are perceived to hold more position power over organization members' decisions than external supervisory bodies. As these bodies are formally appointed by the organization and due to this internal position, they can more closely monitor and control organization members' work actions (Finkelstein, 1992; John & Senbet, 1998). Therefore, these bodies, compared to external supervisory bodies, can more directly and more immediately administer rewards and punishments for organization members' behavior, and thus can have a stronger influence on organization members' decisions (Brass et al., 1998).

In addition, research shows that, internal supervisory bodies are also perceived to have higher levels of personal power, because they can, unlike external supervisory bodies, create a shared commitment among organization members to organizational goals, by using their personal relationships and because they represent the ethical values of an organization (Brass et al., 1998; Cole, Schaninger, & Harris, 2002; Yukl & Falbe, 1991). With such perceived personal power internal supervisory bodies can provide social approval to organization members, and therefore they can have a stronger influence on these members' decision making (French & Raven, 2001).

Based on the above, compared to external supervisory bodies, we argue that internal supervisory bodies' are perceived to hold more position and personal power. As internal supervisory bodies have more direct access to organization resources on which organization members depend, and this dependency shapes these members' motivation to make less self-serving decisions (Brass et al., 1998). So, even though we believe external supervisory bodies are perceived to hold some power and influence over organization members' decisions, we expect this impact to be stronger for internal supervisory bodies. In other words, we propose that internal supervisory bodies are perceived to hold more power over organization members than external supervisory bodies do, and therefore they will have a stronger negative relationship with organization members' self-serving decisions in comparison. Formally stated:

Hypothesis 4a: Internal supervisory bodies are perceived to hold more position and personal power over organization members than external supervisory bodies do.

Hypothesis 4b: Internal supervisory bodies' perceived personal and position power mediates the stronger negative relationship between the presence of internal supervisory bodies and organization members' self-serving decisions.

Finally, in addition to testing this fourth hypothesis, we also conducted Study 2.2 to rule out a possible alternative explanation for why internal supervisory bodies may have a stronger negative relationship to organization members' self-serving decisions than external supervisory bodies. Some scholars suggest that internal supervisory bodies are so impactful because they are simply more proximal to organization members (Frink & Klimoski, 1998). So, rather than that internal supervisory bodies are perceived to hold more position and personal power over organization members than external supervisory bodies do, the influence of internal supervisory bodies could also be due to the fact that internal supervision is perceived to be closer. Due to this proximity, organization members feel that they are under constant surveillance by internal supervisory bodies. This possibility could explain why the exploratory analysis in Study 2.1 (see the Appendix) revealed that organization members in middle management positions, who are more proximal to internal supervisory bodies than organization members who are not in such a management position, perceived internal supervisory bodies to be most powerful. So, in Study 2.2, we included a proximity measure, but more importantly we focused on organization members with a middle management position only.

Method

Design and sample. This study used a one factorial (presence of supervisory body: internal supervisory body present/external supervisory body present/both supervisory bodies present) between-subjects design[3]. We recruited specifically organization members with management experience (i.e., organization members who occupied a position as middle manager) in the financial sector, through snowball sampling by using personal networks. We aimed for a minimum of 80 organization members, but ended up with 62 members from different organizations who filled out the questionnaire correctly. Of these participants, 29% was female (M_{age} = 38.79, *SD* = 13.02; $M_{\text{years of work experience}}$ = 12.42, *SD* = 11.42) and 94% held a college degree or higher. Participation in the study was voluntary, and the participants were randomly and equally assigned to one of the three conditions (roughly 20 participants per condition) and received all study materials online.

Scenario. The participants were presented with a hypothetical decision dilemma adapted from Pitesa and Thau (2013), but realistic for the daily business practice of financial middle managers. They had to decide how much money the organization should invest in a new business project. The hypothetical project could be highly profitable due to its size and prospects, but also carried significant risks because its feasibility was difficult to estimate. Participants learned that they would get a sizeable bonus if the project would be successful. In case of failure, there would be no major personal consequences for the organization members (e.g., job loss); only the organization's performance and market position would be at stake. As such, the investment decision implied moral hazard, in the sense that the participants could maximize their own utility to the detriment of others (Kotowitz, 2008), which represents an opportunity for making self-serving decisions.

[3] We originally also designed a condition where both supervisory bodies were *absent*. However, most of the participants who were assigned to this condition failed the manipulation checks because they were reluctant to believe that they did not have to justify their actions to any supervisory body. Similar difficulties are reported in previous research (see Skitka, Mosier & Burdick, 2000). This condition was therefore removed from the study design.

Presence of supervisory bodies (manipulation). After the participants had read about the business project, we introduced the presence of a supervisory body to whom they had to justify their decision (based on Frink & Ferris, 1998). In the internal supervision condition, the participants learned that they had to justify their decision to internal supervisory bodies within the organization, which control whether they act in line with formal internal policy rules (e.g., an organization's management board or an internal audit committee). In the external supervision condition, the participants learned that they had to justify their decision to external supervisory bodies outside the organization, which control whether they act in line with formal external legal rules (e.g., tax supervisory bodies or external accountants). In the condition where both supervisory bodies were present, the participants received information about the internal and external supervisory bodies (with the internal supervisory bodies always presented first).

To test the effectiveness of this manipulation, the participants had to answer three checks at the end of the questionnaire that contained our dependent measures (see Frink & Ferris, 1998; Siegel-Jacobs & Yates, 1996): 1)"I had to justify my investment decision"; 2) "I was held accountable for my decision by an internal supervisory body"; and 3) "I was held accountable for my decision by an external supervisory body". All questions had to be answered on a 7-point scale ranging from 1 ("*strongly disagree")* to 7 ("*strongly agree"*).

The results of a series of one-way ANOVAs with the manipulation conditions as independent factor confirmed that across all three conditions, participants felt that they had to justify their decision, $M_{\text{average}} = 5.60$, $SD_{average} = 1.06$, F (2, 59) = .980, p = .38, η^2= .03. Moreover, we found the intended results on the second check; in the condition with the presence of only an internal supervisory body and in the condition where both supervisory bodies were present, participants believed more strongly that they were held accountable by an internal supervisory body (respectively M = 5.90, SD = .85 and M = 6.14, SD = .48), than in the condition with only external supervisory bodies (M = 4.76, SD = 2.07), F (2, 59) = 6.44,

p = .00, η^2= .18. Post hoc testing (Tukey HSD) revealed that the first two conditions did not differ significantly from each other (p = .83). Finally, the results on the third check were also in the expected direction; in the condition with external supervisory bodies only and in the condition where both supervisory bodies were present, participants believed more strongly that they were held accountable by an external supervisory body (respectively M = 5.00, SD = 1.55 and M = 5.38, SD = 1.53), than in the condition with internal supervisory bodies only (M = 3.80, SD = 1.93), F (2.59) = 4.92, p = .01, η^2= .14. The first two conditions did not differ significantly from each other (Tukey HSD post hoc test, p = .74). Together, the results thus demonstrate that our manipulation was successful.

Measures

Self-serving decision. Participants' tendency to make a self-serving decision was measured with one continuous item; "How much money would you invest in the new business project?" The answering scale ranged from 0 Euros to 1.000.000 Euros (following Pitesa & Thau, 2013). A higher score on this measure refers to more self-serving decisions since the investment of a large amount of money carried risks for the organization only, not for the participants. The participants could in fact benefit from this investment personally (i.e., in terms of a larger bonus), when the project turned out to be successful.

Perceived power bases. The extent to which participants perceived each supervisory body to hold *position power* over them, was measured with the following four items developed by French and Raven (1959): "These supervisory bodies can: 1) influence my personal pay level; 2) influence whether or not I get a pay raise; 3) influence whether or not I get a promotion; and 4) provide me with special benefits". Together these items formed a reliable scale (α = .94). The extent to which participants perceived each supervisory body to hold *personal power* over them was also measured with four items from French and Raven (1959): "These supervisory bodies can: 1) make me feel valued; 2) make me feel like they approve of me; 3) make me feel accepted; and 4) make me feel important as a person". These items also formed a reliable scale (α = .92). All questions had to be answered on a 7-point scale ranging from 1 ("*strongly disagree")* to 7 ("*strongly agree"*).

Perceived proximity. The extent to which participants perceived each supervisory body to be relatively close to them was measured with three self-developed items: 1) "I expect to meet these supervisory bodies on a regular basis"; 2) "I expect to have personal contact with these supervisory bodies."; and 3) "I expect to give personal updates to these supervisory bodies". These three items also had to be answered on a 7-point scale ranging from 1 ("*strongly disagree")* to 7 ("*strongly agree"*) and formed a reliable scale (α = .93).

Results

Descriptive statistics. Table 2.2 represents the means, standard deviations and Pearson zero-order correlations for all study 2.2 variables. This table shows that only position power is correlated with participants' self-serving decisions. Proximity was associated with both perceived power bases of supervisory bodies. Interestingly, Table 2.2 further shows that position power and personal power are positively correlated.

TABLE 2.2

Descriptive Statistics and Correlations among Variables in Study 2.2

Variables	Mean	S.D.	1.	2.	3.	4.
1. Self-serving decisions	56.1451.63	33.3903.13				
2. Position power	3.95	1.85	-.36**			
3. Personal power	4.72	1.50	-.16	.51**		
4. Proximity	5.00	1.58	-.14	.35**	.43**	

N = 62 * *p* < .05, ** *p* < .01 (two-tailed)

Hypotheses testing. The results for our dependent variables were obtained by performing a series of one-way ANOVAs with the manipulation condition as the independent factor. We tested our Hypotheses 1-3 again, that internal supervisory bodies are more stronger negatively related to participants' self-serving decisions, because they are perceived to hold more power than external supervisory bodies. Moreover, we tested Hypothesis 4A-B, predicting that internal supervisory bodies are perceived to hold more position and personal power than external supervisory bodies do, and that this explains these bodies' stronger negative relationship with participants' self-serving decisions.

Self-serving decision. The results of the ANOVA on participants' self-serving decision revealed a main effect of the supervisory bodies manipulation (F [2, 59] = 3.87, p = .03 η^2 = .12). Participants were significantly less inclined to invest money in the business project (i.e., made a decision that was less self-serving) in the condition with internal supervisory bodies only (M = 402.500 Euros, SD = 355.215 Euros) than in the conditions with external supervisory bodies only (M = 669.048 Euros, SD = 298.947 Euros), or with both supervisory bodies present (M = 605.238 Euros; SD = 302.285 Euros; Tukey post hoc, p = .03 for the internal supervisory bodies-only versus external supervisory bodies-only contrast, p = .80 for the external supervisory bodies-only versus both supervisory bodies contrast). So, in line with Hypothesis 1, the results show that the presence of internal supervisory bodies was more strongly negatively related to participants' self-serving decisions than the presence of external supervisory bodies, and also stronger than the combined presence of both bodies.

Perceived power bases. The results of the ANOVA on perceived position power of the supervisory bodies revealed a main effect of the supervisory bodies manipulation (F [2, 59] = 5.40, p = .01, η^2 = .15). Participants believed that external supervisory bodies alone held significantly less position power (M = 2.95, SD =1.55) than internal supervisory bodies alone (M =4.27, SD = 1.76), or than both supervisory bodies combined (M = 4.63, SD = 1.89;

Tukey post hoc, $p = .05$ for the external supervisory bodies-only versus internal supervisory bodies-only contrast, $p = .80$ for the internal supervisory bodies-only versus both supervisory bodies contrast).

For personal power, the results of the ANOVA revealed a similar pattern (F [2, 59] = 6.31, $p = .00$, $\eta^2 = .18$). Participants believed that external supervisory bodies alone hold significantly less personal power ($M = 3.84$, $SD = 1.60$) than internal supervisory bodies alone ($M = 5.17$, $SD = 1.38$), or than both supervisory bodies combined ($M = 5.19$, $SD = 1.19$; Tukey post hoc, $p = .01$ for the external supervisory bodies-only versus internal supervisory bodies-only contrast, $p = 1$ for the internal supervisory bodies-only versus both supervisory bodies contrast). Together, these results support Hypothesis 2, such that internal supervisory bodies are perceived to be more powerful than external supervisory bodies, and Hypothesis 4a, such that internal supervisory bodies are indeed believed to hold more position and personal power than external supervisory bodies do. However, external supervisory bodies' position power was lower than expected. Interestingly, a combination of the two supervisory bodies was also perceived to be relatively powerful in terms of position as well as personal power.

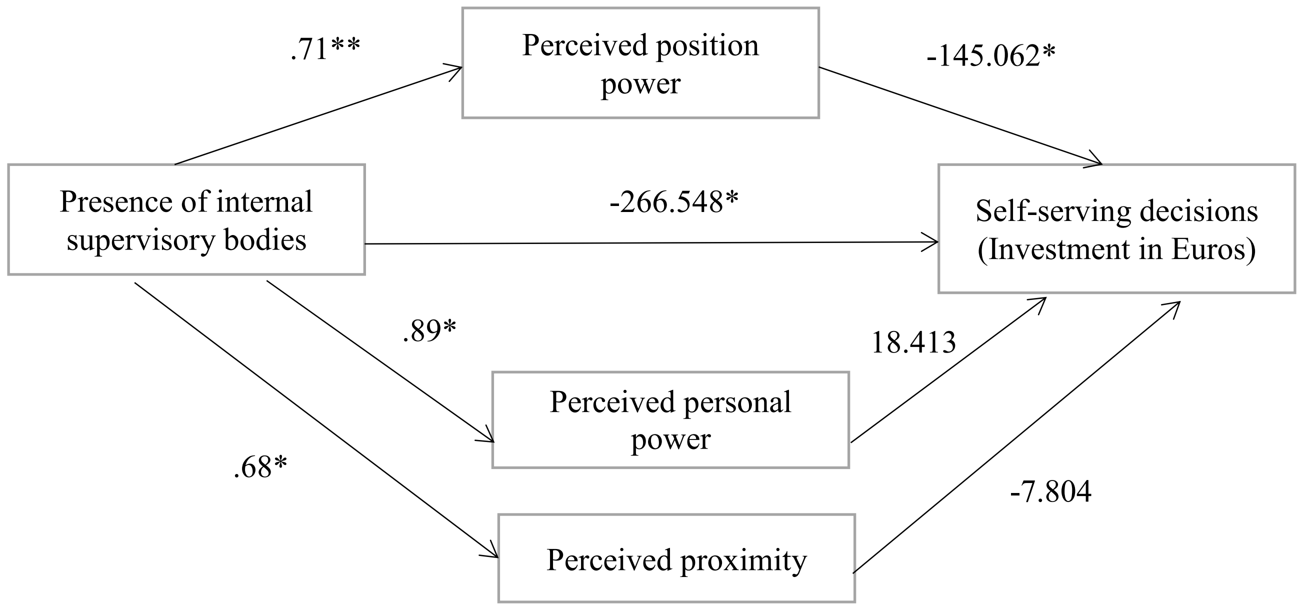
Proximity. The results of the ANOVA on perceived proximity of the supervisory bodies also revealed a main effect of the supervisory bodies manipulation (F [2, 59] = 7.25, $p = .00$, $\eta^2 = .20$). Participants believed that external supervisory bodies alone were significantly less proximal to them ($M = 4.08$, $SD = 1.91$) than internal supervisory bodies alone ($M = 5.18$, $SD = 1.29$) or both supervisory bodies combined ($M = 5.75$, $SD = .94$; Tukey post hoc, $p = .04$ for the external supervisory bodies-only versus internal supervisory bodies-only contrast, $p = .43$ for the internal supervisory bodies-only versus both supervisory bodies contrast). These results demonstrate that internal supervisory bodies are indeed perceived to be more proximal than external supervisory bodies. It is worth nothing, however, that a combination of the two supervisory bodies was also believed to be highly proximal.

Mediation. To test our mediation Hypothesis 4b, we contrasted the internal supervisory bodies-only condition and the external supervisory bodies-only condition against the condition were the respective body was absent (see Field, 2005). For this purpose, we created an 'internal supervisory bodies' dummy by labelling the internal supervisory bodies-only condition as "1" and the external supervisory bodies-only condition as "0", and an 'external supervisory bodies' dummy by labelling the external supervisory bodies-only condition as "1" and the internal supervisory bodies-only condition as "0". We subsequently used a bootstrapping technique developed by Hayes (2012) to test for multiple mediation patterns in the relationship between the presence of internal supervisory bodies and participants' self-serving decisions, while controlling for the presence of external supervisory bodies. With this technique (Model 4 of the process macro, Preacher & Hayes, 2008), we could test and compare the explanatory value of our two mediators, internal supervisory bodies' position power and personal power, in relation to participants' self-serving decisions. Interestingly, the results revealed a significant indirect effect for internal supervisory bodies' position power only (B = -103.122, SE = 72.666, p = .37; CI 95%= -312,909, -12.043, N = 41; 5000 re-samples), and not for their personal power (B = 13.108, SE = 58099, p = .80; CI 95% = -89.568, 148.155). These findings suggest that the relationship between the presence of internal supervisory bodies and participants' self-serving decisions was primarily explained by their *position* power.

To test the alternative explanation that proximity explains why the presence of internal supervisory bodies is stronger related to participants' self-serving decisions than the presence of external supervisory bodies, we conducted a second multiple mediation analysis where proximity was added as a third possible mediator. However, again we did not find a significant indirect effect for proximity (internal supervisory bodies dummy; B = -5.347, SE = 47.459, p = .89; CI 95% = -117.563, 80.562). Moreover, the inclusion of this additional mediator variable did not change the found indirect effects of internal supervisory bodies' position and personal power significantly. Accordingly, we can conclude that the stronger negative relationship of internal supervisory bodies with participants' self-serving decisions was not due to their degree of closeness to the participants. For an overview of the combined results of these analyses see Figure 2.1.

FIGURE 2.1

Path Model for Mediation of Two Power Bases and Proximity in the Relationship between the Presence of Internal Supervisory Bodies and Participants' Self-serving Decisions in Study 2.2



Discussion

The results of Study 2.2 also largely confirm our Hypotheses 1-3. Again, we found that the presence of internal supervisory bodies was more strongly negatively related to participants' self-serving decisions than the presence of external supervisory bodies, because participants believed that internal supervisory bodies held more power over them (compared to external supervisory bodies). We further predicted (Hypothesis 4a) that internal supervisory bodies are perceived to hold more position and personal power over organization members than external supervisory bodies do. The results of Study 2.2 also support this hypothesis, as participants indeed believed that internal supervisory bodies possess more power derived from these sources than external supervisory bodies do, and almost to the same extent as a combination of the two supervisory bodies. However, contrary to what we had expected (see Hypothesis 4b), the results also showed that only internal supervisory bodies' position power (i.e., their ability to reward and punish organization members) directly explained the stronger negative relationship of internal supervisory bodies with participants' self-serving decisions. Moreover, it turned out that the combination of supervisory bodies was less strongly related to participants' self-serving decisions than the presence of internal supervisory bodies alone, despite their equally high levels of power. We will elaborate on these issues in the general discussion below.

OVERALL DISCUSSION

Our research adheres to public calls to examine how to prevent that organization members make self-serving decisions that may harm their organization and customers. Therefore, this research drew on literature in the areas of corporate governance and organizational behavior, to articulate a contingency theory of the relationships between the presence and power levels of internal and external supervisory bodies with organization members' self-serving decisions. Across a large field survey and an experimental study, we found that the sole presence of internal supervisory bodies was more strongly negatively related to organization members' self-serving decisions than the sole presence of external supervisory bodies, or the combined presence of both bodies. So, simply combining internal and external supervisory bodies did not automatically provide an additive advantage. These results further showed that this stronger influence of internal supervisory bodies is explained by their higher power over organization members compared to external supervisory bodies.

Study 2.2 additionally demonstrated that the stronger relationship of internal supervisory bodies with participants' self-serving decisions was *not* explained by their high level of perceived personal power over organization members or by their high degree of perceived proximity to organization members. Instead, the presence of internal supervisory bodies was stronger related to participants' self-serving decisions, because they are perceived to hold more *position* power over organization members (at least more so than external supervisory bodies do).

Theoretical Implications

The findings presented in this chapter have several important implications for existing corporate governance and organizational behavior literature. First, our findings imply that the impact of supervisory bodies on organization members' decisions is indeed contingent on *who* is holding organization members accountable (Pennington & Schlenker, 1999), and in particular that internal and external supervisory bodies have a significantly different impact on organization members' decisions. Although corporate governance researchers find that external supervisory bodies have an impact on organizational outcomes and CEO decisions (e.g., Laeven & Levine, 2009; Westphal, 1998), our results show that they are less strongly related to the day-to-day decisions of lower level individual organization members than internal supervisory bodies. This finding supports research in organizational behavior suggesting that internal supervisory bodies have more control over the concrete work activities of organization members than external supervisory bodies do (Platow & Van Knippenberg, 2001).

Second, we predicted and found that internal supervisory bodies are perceived to hold more power over organization members, and in particular more position and personal power, than external supervisory bodies do. However, the level of perceived position power for external supervisory bodies was lower than expected. This result may be due to the fact that these bodies can only reward and punish organization members *indirectly* through fining the organization or by influencing the incentives of its top management instead of its organization members (Adams & Ferreira, 2012). In this light, certain traditional viewpoints in corporate governance literature may need to be reconsidered, such as the idea that external supervisory bodies are effective because of their strong formal intervention powers (Barth, Lin, Ma, Seade, & Song, 2013; Beck & Laeven, 2006).

Third, although organizational behavior scholars have theoretically explained the ability of internal and external supervisory bodies to impact organization members' self-serving decisions through their respective power bases (Rus, Van Knippenberg, & Wisse, 2011), our research demonstrates this link empirically and shows that position power is more important for internal supervisory bodies than personal power. Hence, our results suggest that organization members' decisions are more dependent on this position power of internal supervisory bodies to provide or withhold organizational resources (rewards and punishments; Emerson, 1962). So, by explaining *why* organization members are affected differently by internal and external supervisory bodies, the findings have implications for how organizations may choose to control organization members.

Fourth, our findings tentatively suggest that the combined influence of internal and external supervisory bodies may not immediately have an additive value in relation to individual organization members' self-serving decisions. At first sight we thus do not find strong evidence for the corporate governance view that external supervisory bodies as the stronger party *automatically* complements the presence of internal supervisory bodies (Walsh & Seward, 1990). Our findings could imply that, next to the attention for external supervisory bodies, organizations could increase awareness among organization members about the presence of internal supervisory bodies that control them.

Strengths, Limitations, and Future Research

The research presented in this chapter has several strengths. First, we used different populations across our two studies; Study 2.1 used organization members (i.e., middle managers and employees) from a wide range of organizations, whereas Study 2.1 used financial middle managers. Second, we measured organization members' self-serving decisions in general terms (Study 2.1) *and* in relatively specific terms (i.e., investing in a risky business project which may harm the organization but not the self-interest, Study 2.2). Third, we captured the naturally occurring relationships between internal and external supervisory bodies, their power levels, and organization members' decisions in Study 2.1, and established the causal direction of these relationships with an experimental scenario in Study 2.2. Finally, our findings largely replicated across the two studies, leading to greater confidence in the ability to generalize our findings.

Nonetheless, our research suffers from some limitations as well. For example, we did not go beyond observing organization members' intentions to engage in self-serving decisions. So, we recognize that future research could employ more objective data from real organization members' behavior in order to further establish the validity of our findings.

Another limitation of our work is that we defined the presence of internal and external supervisory bodies in relatively general terms. In this way, we could ensure that all respondents, who worked in a wide range of different organizational contexts, were sufficiently familiar with the examples we provided for both internal and external supervisory bodies. In doing so, however, we left out certain specific kinds of internal and external supervisory bodies that apply to specific sectors. In the financial sector, for example, external supervisory bodies consist of independent and/or governmental, legal supervisory authorities, such as the Federal Reserve in the United States, which may be seen as more powerful than the external supervisory bodies highlighted in the current chapter. As, for example, external accountants may have a different power position and less independence, because of their relation with client firms, which can impact their influence (Chan & Wu, 2011). Moreover, we also did not include certain specific internal supervisory bodies that are more common in larger organizations, such as the internal supervisory board and internal compliance function.

It is therefore important that future research creates more certainty under which circumstances specific internal and external supervisory bodies have an impact on organization members' decisions (see also Chapters 3 and 4 of this dissertation).

Moreover, given their joint occurrence in real life, we also examined the combined impact of internal and external supervisory bodies on organization members' decisions. We took an exploratory approach to this question as to date, little is known about the effects of the combination of both supervisory bodies (Green et al., 2000), and there are diverging theoretical views whether it creates an additive advantage. The results of both studies presented in this chapter suggest that the combination of supervisory bodies may not automatically have an additive value. However, this result should be interpreted with care, as there may be circumstances or other behavioral group processes that we did not consider yet that could determine and explain the exact nature of their relationship (Ward, Brown & Rodriguez, 2009). After all, organization members did believe that the two supervisory bodies together held high degrees of position and personal power. One possible reason why this situation did not impact organization members' self-serving decisions could be that the added presence of an external supervisory body triggers organization members to believe that the *organization* has to justify her actions to these supervisory bodies, rather than organization members personally (Sinclair, 1995). Or, the combination of the two supervisory bodies may have confused organization members as to whom they have to justify their actions, or bodies communicate different norms to organization members and therefore members may try to avoid accountability altogether (Green et al., 2000). Accordingly, we acknowledge that more research into the combined effects of both supervisory bodies and the role of contextual factors and behavioral group processes is needed, in order to create a more comprehensive understanding of the respective impact and relationship of these bodies (see also Chapter 4 of this dissertation).

Finally, our research also raises the question of whether internal supervisory bodies will have a lasting impact on organization members' self-serving decisions if they primarily rely on their positon power. Although there is meta-analytical proof that the ability to reward and punish others directly indeed enhances organization-interested decisions among organization members (Balliet, Mulder, & Van Lange, 2011), there is also research demonstrating that such control has a negative side, particularly when used by supervisory bodies within an organization (Subašić, Reynolds, Turner, Veenstra, & Haslam, 2011). For example, one study suggests that internal supervisory bodies that use position power may reduce organization members' sense of autonomy (Pierro, Cicero, & Raven, 2008), which may hinder the intrinsic motivation to demonstrate the desired behavior in the long term (Deci, Koestner & Ryan, 1999; Gagne, 2003; Joussemet, Koestner, Lekes, & Houlfort, 2004). Hence, internal supervisory bodies that predominantly stress their position power could yield mere short-term compliance, and may be unable to maintain control over organization members' decision-making behavior in the long run. It would therefore be worthwhile to re-examine the effects of internal and external supervisory bodies on organization members' decisions with a longitudinal research design.

Conclusion and Practical Implications

In conclusion, the financial crisis and organizational scandals, such as the Libor case, have emphasized the importance of internal and external supervisory bodies to control organization members' decision-making behavior. This research shows that internal supervisory bodies relate to organization members' self-serving decisions more strongly than external supervisory bodies, through their higher levels of position power. Based on our findings we advise organizations to make more use of the potential influence of internal supervisory bodies. In most situations, however, both external and internal supervisory bodies are present. In these cases, we advise external supervisory bodies to collaborate closely with, and exert their influence via, internal supervisory bodies, rather than to work independently from them. In addition, external supervisory bodies can make organization members more aware that, in addition to controlling organizational-level outcomes, they also control their personal day-to-day activities.

APPENDIX

Exploratory Analyses

In Study 2.1 we also explored how adding organization members' management experience (i.e., experience in a position as middle manager or equivalent) to our conceptual model as an additional moderator (and not as a control variable) would affect the hypothesized relationships. In a series of OLS regression analyses, the presence of internal supervisory bodies, the presence of external supervisory bodies and organization members' management experience were entered as independent predictors in step 1. All possible two- and three-way interaction terms between the presence of internal supervisory bodies, the presence of external supervisory bodies and organization members' management experience were entered in step 2.

Organization members' management experience did not significantly interact with the presence of internal supervisory bodies, the presence of external supervisory body or their joint presence to predict organization members' self-serving decisions (lowest p-value; B = -.14, p = .34), nor did it affect the results we initially obtained on this variable.

Organization members' management experience also did not change the main results we obtained on the perceived power level of external supervisory bodies. There was only an additional significant interaction between the presence of internal supervisory bodies and organization members' management experience (B = .20, p = .01). This interaction revealed that the presence of internal supervisory bodies also made the meaning of external supervisory bodies more salient when organization members have experience as middle manager.

Adding organization members' management experience as moderator, however, did provide different insights in relation to the main results we obtained on the perceived power level of internal supervisory bodies. Their power level was again significantly predicted by organization members' awareness of their presence (B = .35, p = .00), but this time, the effect was qualified by an interaction with the presence of external supervisory bodies and organization members' management experience ($B = -.13$, $p = .05$). This interaction pattern revealed that organization members perceived internal supervisory bodies to be most powerful when they were clearly aware of their presence, clearly aware of the presence of external supervisory bodies *and* when they had management experience.

CHAPTER 3

THE POWER OF COMPLIANCE: HOW FORMAL COMPLIANCE PROGRAMS AND INFORMAL SHARED ETHICAL VALUES RELATE TO EMPLOYEES' ETHICAL DECISION MAKING[4]

ABSTRACT

This chapter examines how internal supervision by the compliance function and its program of activities (i.e., formal compliance programs), together with informal shared ethical values, such as integrity, are related to employees' unethical behavior and ethical awareness. We predict that formal compliance programs and informal shared ethical values will both impact these outcomes, and also explore their joint impact. We expect that they do so through signaling power of compliance officers based on, respectively, compliance officers' formal position (i.e., position power), or their personal characteristics (i.e., personal power). The results of a field survey among 78 compliance officers show that either formal compliance programs or informal shared ethical values are negatively related to unethical behavior and positively related to ethical awareness among employees. Yet the combined presence of formal compliance programs and informal shared ethical values did not have a stronger impact. Additionally, the relationships between informal shared ethical values and these outcomes were explained by compliance officers' perceived personal power, but position power did not explain the predicted relationships for formal compliance programs. This chapter enriches our understanding of how internal supervision by the compliance function, in conjunction with organizational values, relates to sound decision making, and the explanatory role of compliance officers' power.

[4] This chapter is an adapted version of De Waal, M., Stoker, J., & Rink, F. (2015). Formal and Informal Dimensions of Compliance Effectiveness. *Business Compliance, 02*, 15-27.

Whenever corporate fraud scandals occur that harm societal interests, there is immediate public discourse on whether supervision of these organizations was adequate to safeguard sound decision making. Public criticism primarily focuses on the role of *external* supervision by independent or government authorities, responsible for supervising an industry's adherence to the law (Barth, Caprio & Levine, 2004), and their lack of timely intervention to protect the public interest. Yet, several scandals illustrate the ineffectiveness of *internal* supervision by the compliance function, responsible for ensuring that employees follow formal legislations and ethical standards (Basel Committee for Banking Supervision, 2005). Such ineffective internal supervision can result in unethical behavior that harms the organization's interest, including its integrity, reputation and continuity (Ethics & Compliance Initiative, 2016a; Van Riel & Fombrun, 2007). For example, at ING, a large Dutch systemic bank, the internal controls failed due to inadequate execution of compliance policies regarding client due diligence and transaction monitoring, which enabled money laundering and consumer bribing through the bank's accounts (Financial Times, 2018). This resulted in a large regulatory fine of 775Mio Euros, as well as public outrage and reputational damage. Such cases raise the question of how internal supervision by the compliance function can reduce unethical behavior and increase a sense of ethical awareness among employees within organizations[5] (Kaptein, 2015; Weaver & Treviño, 1999).

To achieve this kind of behavior the compliance function or department present in most organizations executes a formal compliance program of activities, including codes of conduct, monitoring and training programs (Ethics & Compliance Initiative, 2016b; Kaptein, 2015). Such compliance programs are indeed found to effectively influence employees' unethical behavior and ethical awareness (e.g., Kaptein, 2015; Rottig, Koufteros, &

[5]Although these outcomes are linked, they are not automatically related (Rest, 1986), as increasing ethical awareness will not immediately reduce unethical behavior, because this requires motivating employees to change their behavior (Deci & Ryan, 1995). Nonetheless, such ethical awareness is important, as it helps employees to recognize and report unethical behavior (e.g., Weaver & Treviňo, 1999). Therefore, we focus on both outcomes as dependent variables.

Umphress, 2011). Moreover, research shows that employees' ethical behavior is also greatly influenced by the presence of informally shared ethical values within their organization, for example the degree to which it embraces integrity (Paine, 1994, Weaver & Treviño, 1999; for a meta-analysis, see Kish-Gephart, Harrison, & Treviño, 2010). Hence, organizations can effectively reduce unethical behavior and increase ethical awareness by having *either* a formal compliance program or informal shared ethical values.

It remains to be investigated how formal compliance programs and informal shared ethical values work together when they are *both* present in organizations, as there is mixed evidence in this regard. Ethics scholars argue, that there should be a stronger combined effect in reducing unethical behavior if both characteristics are consistent in promoting ethical behavior (Tenbrunsel, Smith-Crowe, & Umphress, 2003; Weaver, Treviño, & Cochran, 1999). Although there is some evidence for this surplus effect (Weaver & Treviño, 1999), other research shows that the combined presence of formal compliance programs and informal shared ethical values can also have negative effects and create more unethical behavior (McCabe, Treviño & Butterfield, 1996; Smith-Crowe, Tenbrunsel, Chan-Serafin, Brief, Umphress, & Joseph, 2015).

Moreover, there is little insight into *why* formal compliance programs and informal shared ethical values influence employees' unethical behavior and ethical awareness, and there is especially little clarity about the role of compliance officers in this regard (Kish-Gephart et al., 2010; Treviño, Den Nieuwenboer, Kreiner, & Bishop, 2014). Based on power literature, we propose that formal compliance programs and informal shared ethical values signal different sources of control, or power bases, of compliance officers over employees' ethical behavior (Anderson & Berdahl, 2002; Keltner, Gruenfeld, & Anderson, 2003). We argue that the relationship between formal compliance programs, on the one hand, and employees' unethical behavior and ethical awareness, on the other hand, can be explained by compliance officers' *position* power (Kaptein, 2011; Weaver & Treviño, 1999). Such position power, based on compliance officers' formal task to enforce these programs by sanctioning rule violations (French & Raven, 2001), is argued to make employees refrain from unethical behavior and become more ethically aware (e.g., Thomas & Bishop, 1984; Treviño, Butterfield, & McCabe, 1998; Weaver & Treviño, 1999). Moreover, we propose that the relationship between informal shared ethical values and employees' unethical behavior and ethical awareness, can be explained by compliance officers' *personal* power. Such personal power, based on compliance officers' personal characteristics (French & Raven, 2001), as representatives of these ethical values such as integrity (i.e., prototypicality, Van Knippenberg & Hogg, 2003; Ethics & Compliance Initiative, 2016a), makes them trusted role models for employees' unethical behavior and ethical awareness (Van Knippenberg, 2011).

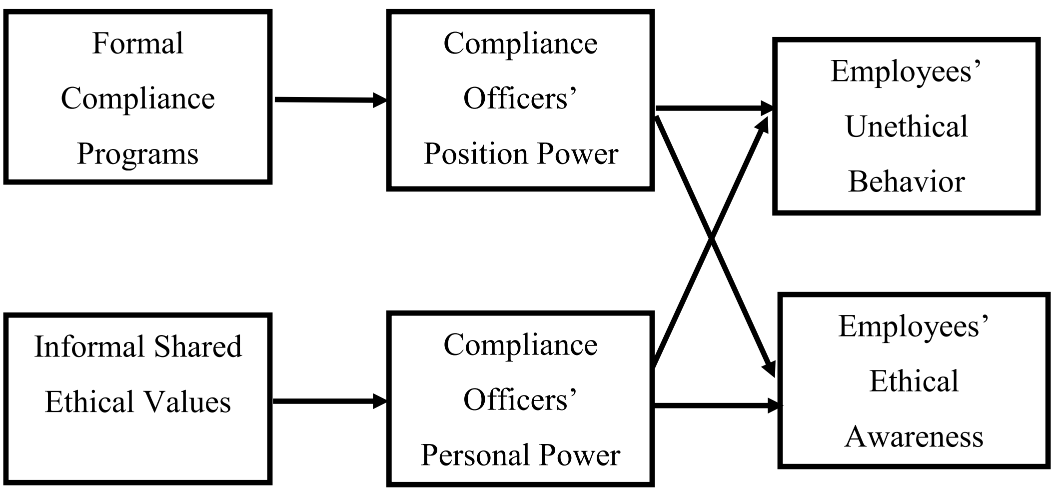
In sum, this chapter presents a conceptual model of *how* and *why* formal compliance programs and informal shared ethical values relate to unethical behavior and ethical awareness among employees. Our central research goals are to, 1) investigate the relationships of formal compliance programs and informal shared ethical values with these employee outcomes, and explore their interactive relationship, and 2) to study the role of compliance officers' position power and personal power bases as underlying mechanisms of these relationships.

This research makes two important contributions to corporate governance literature and ethical decision-making literature. First, prior research has focused on the isolated effects of either formal compliance programs (Kaptein, 2015; Rottig et al., 2011), or informal shared ethical values in relation to employees' unethical behavior and ethical awareness (Treviño, 1990). However, these organizational characteristics are highly related and are often both present in practice (Granovetter, 1985; Tenbrunsel et al., 2003), and in line with similar calls made by governance scholars we will therefore explore their interactive relationship (Davidson, Dey, & Smith, 2015). In this way, we aim to increase our understanding of the independent and combined impact of both formal compliance programs and informal shared ethical values in relation to sound decision making by employees in organizations.

Second, by examining compliance officers' power bases as possible underlying mechanisms we aim to explain how formal compliance programs and informal shared ethical values relate to employees' unethical behavior as well as their ethical awareness. Understanding which sources of power underlie these relationships, can help organizations to better communicate the role of compliance officers in organizations and thereby improve employees' ethical decision making. In this regard, our research adds new insights to corporate governance literature about how internal supervision by the compliance function impacts ethical decision making (Kaptein, 2015), and thereby provides practical understanding of the role of compliance in organizations (Treviño et al., 2014). We have conducted a field survey among a professional sample of 78 compliance officers from different organizations, which provides insight into how compliance officers evaluate their own position and personal power bases and how these power bases relate to employees' unethical behavior and ethical awareness. In the next sections we introduce the hypotheses of our conceptual model (see Figure 3.1) and theoretical framework for this study.

FIGURE 3.1

Conceptual Model



THEORY AND HYPOTHESES

The Role of Formal Compliance Programs and Informal Shared Ethical Values

Ethics scholars argue that formal compliance programs and informal shared ethical values can both influence employees' unethical behavior and ethical awareness (e.g., Kaptein, 2015; Rottig et al., 2011; Tenbrunsel et al., 2003; Treviño, 1990, Treviño, Gibson, Weaver, & Toffler, 1999). Formal compliance programs are primarily designed to reduce unethical behavior and increase ethical awareness, and for this purpose these programs usually consist of codes of conduct, ethical awareness training, monitoring and hotlines to report misconduct (Ethics & Compliance Initiative, 2016b; Kaptein, 2015). The presence of such multi-facetted formal compliance programs influences employee behavior by signaling that unethical behavior is *undesired* in an organization, which will make employees refrain from such behavior (Treviño et al., 1999; Weaver & Treviño, 1999).

Studies indeed demonstrate that multi-facetted formal compliance programs are negatively related to employees' unethical behavior (Kaptein, 2015; Weaver & Treviño, 1999), for instance because employee activities are closely monitored (Kaptein, 2015), and due to ethics training (Warren, Gaspar, & Laufer, 2014). Furthermore, research shows that formal compliance programs are positively related to ethical awareness of employees (Rottig et al., 2011; Weaver & Treviño, 1999), especially when they clearly communicate the compliance rules to employees (Rottig et al., 2011), and train employees to recognize ethical issues (Rottig & Heischmidt, 2007).

Moreover, employees are strongly influenced by the presence of informal shared ethical values, such as integrity (Paine, 1994), which shape the ethical culture of an organization (Treviño, 1990; Weaver & Treviño, 1999)[6]. These informal shared ethical values

[6] The concept of ethical culture is often used interchangeably with ethical climate (Victor & Cullen, 1987, 1988), as they are conceptually overlapping and empirically closely related (Kish-Gephart et al., 2010). As both concepts focus on the informal shared ethical values in an organization we will use this term in this chapter to avoid confusion about these concepts.

inform employees about the social organizational norms with regard to *desired* ethical behavior (Schneider, 1990; Treviño et al., 1998), and employees will adapt their behavior in line with these norms to gain acceptance and respect from peers and superiors (Pagliaro, Ellemers, & Barreto, 2011).

Recent research demonstrates that such informal shared ethical values indeed were negatively related to unethical behavior of employees (for a meta-analysis, see Martin & Cullen, 2006; Mayer, Kuenzi, & Greenbaum, 2010), specifically in terms of less unethical choices (for a meta-analysis, see Kish-Gephart et al., 2010), and less ethical violations (Bartels, Harrick, Martell, & Strickland, 1998). Moreover, research shows that the degree to which these informal ethical values are shared was positively related to employees' ethical awareness (Hayibor & Wasieleski, 2009; Butterfield, Treviño, & Weaver, 2000), for instance by increasing their moral imagination (Moberg & Caldwell, 2007). In sum, formal compliance programs and informal shared ethical values are both expected to influence unethical behavior and ethical awareness, because they signal what is (un)desired behavior to employees in relation to ethical decision making. Formally stated we propose the following:

Hypothesis 1: There is a negative relationship between formal compliance programs and employees' unethical behavior, and a positive relationship with employees' ethical awareness.

Hypothesis 2: There is a negative relationship between informal shared ethical values and employees' unethical behavior, and a positive relationship with employees' ethical awareness.

The Role of Power of the Compliance Officer

It remains to be investigated, however, why formal compliance programs and informal shared ethical values have this predicted impact on employees' ethical decision making (Kish-Gephart et al., 2011), and in particular how this is associated with the role of compliance officers in organizations. Based on power literature, it can be argued that these organizational characteristics are both associated with employees' unethical behavior and ethical awareness, because they signal some form of control or power of the compliance officer over employee actions. In fact, those people or bodies that possess such perceived power can motivate employees to change their behavior (Anderson & Berdahl, 2002; Keltner et al., 2003). Literature on power posits that one's power over others can be based on a formal division of roles (i.e., position power), including the power to reward or sanction behavior, or on the basis of personal characteristics of the power holder (i.e., personal power; French & Raven, 2001; Yukl & Falbe, 1991). To date, it is unclear whether both organizational characteristics signal the same kind of power bases of compliance officers to employees, and how these different power bases relate to employees' unethical behavior and ethical awareness.

Ethics scholars argue that formal compliance programs are related to employees' ethical decision making, because they represent the organizational channel that links unethical behavior to sanctions and rewards (Kaptein, 2011; Tenbrunsel et al., 2003). According to deterrence theory, knowing that unethical behavior is sanctioned will make employees refrain from such behavior in order to avoid punishment (Thomas & Bishop, 1984; Williams & Hawkins, 1986). Moreover, sanctions also make employees more ethically aware, as it provides an incentive to increase their knowledge of the compliance rules and their vigilance in ethical situations (Rottig et al., 2011). In other words, active enforcement of formal compliance programs by compliance officers, by detecting and sanctioning unethical behavior (Tyler & Blader, 2005; Basel Committee for Banking Supervision, 2005), ensures that employees believe that such programs are 'followed through', and that when rule violations are detected employee behavior will actually be sanctioned (Treviño & Weaver, 2001; Tenbrunsel & Messick, 1999). Such enforcement could thus provide compliance officers with position power. Accordingly, we argue that the presence of formal compliance programs will be negatively related to unethical behavior and positively related to ethical awareness among employees, because these formal compliance programs will be associated with compliance officers' position power.

Past research offers suggestive evidence for our proposition. For instance, the strongest reduction in unethical behavior is found when formal compliance programs are enforced (Kish-Gephart et al., 2010), such that disciplinary actions are taken when rules are violated (Treviño & Weaver, 2001). Moreover, research shows that compliance's formal power to administer sanctions on the violation of behavioral norms is associated with ethical awareness of employees (Rottig et al., 2011), such as their focus on the ethical aspects in business decisions (Reynolds, 2006; Tenbrunsel & Messick, 1999).

With regard to the influence of informal shared ethical values, however, the social identity theory of leadership (Hogg, 2001), argues that those organizational members who are perceived to embody organizational values – the organizational prototypical members – hold most power over employees' ethical behavior (Hogg & van Knippenberg, 2003; Van Knippenberg, 2000). Central to this concept of prototypicality, is that employees will be open to the influence of these prototypical members, because they trust their organization-oriented intentions, and value their integrity to adhere to the shared ethical values (Giessner & Van Knippenberg, 2008; Mayer, Nurmohamed, Treviño, Shapiro, & Schminke, 2013; Van Knippenberg & Hogg, 2003). Such prototypical members can guide employees' ethical behavior by acting as role models for what is appropriate behavior, and thereby help employees to recognize and deal with ethical situations (Sims & Brinkman, 2002; Van Knippenberg, 2011; Giessner & Van Knippenberg, 2008). Compliance officers are often seen as personal guardians, and thus as representatives or prototypical members, of an organization's integrity (Ethics & Compliance Initiative, 2016a). Based on these characteristics, these officers should have personal power to exemplify the appropriate behavior and show appreciation of employees' ethical behavior. Accordingly, we argue that the presence of informal shared ethical values, and especially integrity, will be negatively related to employees' unethical behavior, and positively related to their ethical awareness, because such values will be associated with personal power of compliance officers.

Prior research indeed suggests that the personal power of prototypical organizational members who act as representatives of informal shared ethical values, are related to employees' ethical decisions. For example, a leader's representativeness predicts his or her effectiveness in influencing employee behavior, because it increases trust in this leader (Giessner & Knippenberg, 2008), and such trust is linked to personal power (Carson, Carson, & Roe, 1993). Moreover, Mayer and colleagues (2013) demonstrate that the effect of ethical role models (i.e., ethical leaders) on employees' unethical behavior is related to the informal shared ethical values in organizations. Finally, high status prototypical members, with more personal power, are found to instigate ethical behavior in their interactions with employees (Ponsioen, 2014), and they can positively influence employees' ethical awareness through role modelling (Dukerich, Nichols, Elm, & Vollrath, 1990).

In sum, formal compliance programs and informal shared ethical values are both expected to influence unethical behavior and ethical awareness, but they do so through different power bases. We expect, on the one hand, that formal compliance programs are related to these outcomes through compliance officers' position power. On the other hand, we expect that informal shared ethical values are related to these outcomes through compliance officers' personal power. Together, this leads to the following hypotheses:

Hypothesis 3: Compliance officers' position power mediates the relationship between formal compliance programs and employees' unethical behavior and ethical awareness, respectively.

Hypothesis 4: Compliance officers' personal power mediates the relationship between informal shared ethical values and employees' unethical behavior and ethical awareness, respectively.

Combined Presence of Formal Compliance Programs and Informal Shared Ethical Values

Formal compliance programs and informal shared ethical values are organizational characteristics that are interrelated and often coexist in organizations (Granovetter, 1985). Some scholars argue, that consistent implementation of formal compliance programs and informal shared ethical values will result in an even stronger effect on employees' unethical behavior and ethical awareness (Maclean & Benham, 2010; Tenbrunsel et al., 2003; Weaver & Treviño, 1999). Moreover, ethics scholars argue that such consistency will increase the linkage between ethical values with employees' daily work responsibilities, and align actual behaviors with formal internal procedures (Treviño et al., 1999). Relatedly, it has been argued that in cases of clear *in*consistency, strong informal shared values can actually undermine the effect of formal compliance programs (Smith-Crowe et al., 2015). Such that, organizations that 'do not walk their talk' run the risk that formal compliance programs become ineffective, because they are not taken seriously by employees and therefore are just mere window dressing (Maclean & Benham, 2010; Treviño & Weaver, 2001).

Empirically, however, there is no consistent evidence for a stronger combined effect of formal compliance programs and informal shared ethical values on unethical behavior and ethical awareness (Smith-Crowe et al., 2015; Treviño et al., 1999; Weaver & Treviño, 1999). For instance, some research clearly shows that the combined presence of both organizational characteristics has the strongest effect on reducing unethical behavior and increasing ethical awareness (Treviño et al., 1999; Weaver & Treviño, 1999). But Treviño and colleagues (1998) found a strong negative effect of informal shared ethical values on unethical behavior for organizations with *and* without codes of conduct as part of their formal compliance program. This finding suggests that it does not hurt to have both characteristics present in organizations. However, other research has found, that when these characteristics are inconsistent in promoting ethical behavior this combination may actually lead to *more* unethical behavior (McCabe et al., 1996). Given these mixed results, we will explore the interactive relationship of formal compliance programs and informal shared ethical values with employees' unethical behavior and ethical awareness.

METHOD

Sample and Procedure

Our study was conducted among compliance officers from different organizations in the Netherlands, mainly active in the financial sector. We gained access to this specific group through a professional association (Vereniging van Compliance Officers, VCO), and an educational institute for compliance officers (Nederlands Compliance Instituut, NCI). These organizations had a combined database of approximately 500 members at the time of data collection. To ensure a maximum response rate we used several techniques, such as personal communication, anonymous and confidential treatment of the answers, and endorsements from both associations (Westphal & Stern, 2005). The survey was distributed in hardcopy on two separate conferences of both associations, and an online version was sent to all members of both associations by email and in newsletters.

In total 81 compliance officers completed the questionnaire (response rate 16%). This low response rate may be due to the fact that participation was completely voluntary, and because the study concerned a large questionnaire. To ensure that our sample was not influenced by extreme cases, we screened the data for outliers following the procedure of Aguinis and colleagues (Aguinis, Gottfredson, & Joo, 2013). In the analyses with both dependent variables, unethical behavior and ethical awareness, 3 observations exceeded the minimum cutoff criteria for Cook's *D*-statistic (>1), Mahalanobis Distance (>15), or DFBETA (>1), and deviated more than 2 to 3 standardized and studentized residuals from their predicted values. These three outlying cases were therefore removed from further analyses.

As a result, our final sample consisted of 78 respondents (M_{age} = 48.36 years, SD = 9.44, 30% female). In this professional sample the respondents were highly educated, including Post doctorates (16%), University (62%) and College (18%) graduates, and 82% of the respondents followed a specific compliance training. The majority of respondents (55%) worked in companies of less than 1000 employees, and 45% worked in organizations with more than 1000 employees. The compliance officers in our sample have, on average, high levels of working experience. Almost 80% of the respondents worked for more than 5 years in their current position and 20% worked up to 15 years in the same function. Moreover, most of the compliance officers in our sample (80%) worked in the financial sector, and of this group 50% worked for 20-40 years in this specific sector. We were unable to check for representativeness of this sample, as there are no official databases available regarding the background of compliance officers in the Netherlands.

Measures

As all the respondents were from the Netherlands, they received a questionnaire that was largely based on Dutch scale items translated from their original English formulation, through double-blind back-translation[7]. All questions were rated on a 7-point scale ranging from 1 (“*strongly disagree”)* to 7 (“*strongly agree”*), unless stated otherwise.

Formal Compliance Programs. The degree to which an organization had a multi-facetted formal compliance program, was measured with the following six items adapted from Kaptein (2015)[8]: 1) “the presence of a compliance department”; 2) “translating regulations

[7] This method implies that after the first translation of the original English measures to Dutch, the Dutch version is then translated back by an independent translator into English, to evaluate its accuracy with the intended meaning of the scale items (Brislin, 1970).

[8] In the survey we also included other compliance activities, in line with Kaptein (2015), such as pre-employment screening, clean desk control, acting as a confidante and investigating incidents. However, our Principal Component Analysis (PCA) revealed that these items did not contribute to a reliable construct (α = .55) and were therefore excluded from further analysis. Based on this PCA with Oblimin rotation on 2 factors with Eigenvalues >1 we found that only 1 factor was reliable with an Eigenvalue of 3.0 (α = .74). Our measure of formal compliance programs is based on the underlying items of this factor. The PCA yielded a sufficient KMO statistic of .68 and a significant Bartlett’s Test of sphercity x^2 (45) = 152.14, p < .0001.

into compliance policy"; 3) "formulating preventive compliance policy"; 4) "compliance training"; 5) "providing compliance advice"; and 6) "monitoring compliance rules". The items were answered on a 7-point scale with the option to indicate that the question was not applicable (9), which we treated as a missing variable. The measure was composed of all items with valid answers and formed a reliable scale (α = .73).

Informal Shared Ethical Values. The degree to which integrity as informal ethical value is shared within the organization was measured with the following two items, loosely based on Paine (1994): In my organization… 1) "integrity is an important core value" and 2) "the reputation regarding integrity is valued highly". Due to the small amount of items, their reliability as a scale was low but close to the threshold (α = .60, Nunnally, 1976), and the inter-item correlation further confirmed that the items measure the same construct (r = .43; Clark & Watson, 1995).

Employees' Unethical Behavior. Our measure of employees' unethical behavior consisted of 10 items developed by Kaptein (2008).[9] Each item was preceded with the phrase 'this incident occurred in the past 12 months…' to provide a relevant timeframe (Treviño & Weaver, 2003): 1) "falsifying or manipulating financial reporting information"; 2) "breaching computer, network, or database controls"; 3) "violating document retention rules"; 4) "providing inappropriate information tot analysts and investors"; 5) "trading securities based on inside information"; 6) "engaging in activities that pose a conflict of interest"; 7)" entering into customer contracts or relationships without the proper terms, conditions, or approvals"; 8) "offering bribes or other improper gifts, favors, and entertainment to influence customers"; 9) "fabricating or manipulating product quality or safety test results"; and 10) "improperly gathering competitors' confidential information". The items were answered on a 7-point scale with the option to indicate that the question was not applicable (9), and we treated this answer

[9] To enhance the questionnaires' relevance for compliance officers in the financial sector we focused on unethical behavior in the categories financers and clients, and we selected the items that reported the highest factor loadings (Kaptein, 2008).

as missing data. The measure was composed of all items that received valid answers and formed a reliable scale (α = .87).

Employees' Ethical Awareness. Ethical awareness among employees of the compliance rules and ability to recognize an ethical situation was measured with the following six items adapted from Treviño and colleagues (1999): 1) "When integrity issues arise employees look for advice from compliance"; 2) "Employees of this organization are quick to notice when a situation raises compliance or integrity issues"; 3) "If someone here knew that a coworker was doing something unethical, he or she would report it to management or compliance"; 4) "Employees of this organization do not hesitate to go to their manager in case of an integrity issue"; 5) "Employees are aware of the compliance rules they have to adhere to"; and 6) "The compliance rules are clear to employees". Together these items formed a reliable scale (α = .82).

Compliance Officers' Perceived Position Power. The extent to which compliance officers believed they hold position power over employees was measured with four items adapted from French and Raven (1959): Compliance can……1) "influence an employees' personal pay level"; 2) "influence whether or not an employee gets a pay raise"; 3) "provide employees with special benefits"; and 4) "influence whether or not employees get a promotion". Together these items formed a reliable scale (α= .68*)*.

Compliance Officers' Perceived Personal Power. The extent to which compliance officers believed they hold personal power over employees was measured with four items adapted from French and Raven (1959): Compliance can….1) "make employees feel valued"; 2) "make employees feel like they approve of them"; 3) "make employees feel accepted"; and 4) "make employees feel important as a person". Together these items formed a reliable scale (α = .78).

Control variables. We included several control variables that have been used in previous ethics research and were found to influence the studied dependent and mediating variables. Specifically, we included organization size as a control variable, as past research has emphasized its relationship with the frequency of unethical behavior and the degree of ethical awareness (Kaptein, 2008). Moreover, we included compliance officers' tenure, in terms of years in the same organization, function and sector, as control variables, as tenure is found to influence their experience with unethical behavior in their organization (Weber & Fortun, 2005). Finally, we included compliance officers' gender as a control variable, as some research suggests that there are differences between men and women when it comes to perceived power bases (Carli, 1999; Ragins & Sundstrom, 1990).

RESULTS

Descriptive Statistics and Confirmatory Factor Analysis

Table 3.1 shows the means, standard deviations, and Pearson zero-order correlations among our measures. The table shows that only organization size as control variable is significantly related to one of our dependent variables, unethical behavior, illustrating its importance as control variable for further analysis (Becker, 2005). The other control variables regarding compliance officers' organization, function or industry tenure, or gender do not relate significantly to any of the dependent variables, unethical behavior and ethical awareness, or mediating variables, compliance officers' perceived position or personal power. Including a large number of controls may affect statistical power and especially if they are non-significant these controls may induce biased parameter estimates (Becker, 2005). To avoid such effects, we excluded these non-significant controls from the main results (Becker, 2005), and we will only use organization size (1= "*less than 50 employees*" to 7= "*more than 1000 employees*") as control variable in the statistical analyses that we report below. [10]

Moreover, in line with Hypotheses 1 and 2, these correlation results show that formal compliance programs are positively related to ethical awareness (r = .30 , p = .01), and informal shared ethical values are negatively related to unethical behavior (r = -.39, p = .00) and positively related to ethical awareness (r = .56, p = .00). Table 3.1 also shows that both dependent variables, unethical behavior and ethical awareness, are negatively related to each other (r = -.28, p = .04).[11]

Finally, we ran a confirmatory factor analysis to assess the convergent validity of the study variables. Given that compliance officers rated all variables, and ethical awareness and unethical behavior, our dependent variables, are interrelated (Rest, 1986), we estimated a model with 6 correlated, first order factors (formal compliance programs, informal shared ethical values, position power, personal power, unethical behavior and ethical awareness). This model was significant and yielded marginal acceptable fit to the data (X^2 = 809,673), *df* = 449, p < .001, CFI = .68, RMSEA = .10, TLI = .63). This indicates that factor loading for each item on its corresponding factor was significant at $p < .001$ (Anderson & Gerbing, 1988; Kline, 1998).

10 To further test the robustness of our results we also re-ran the analyses by including and excluding all control variables. Moreover, we performed an extra regression analysis on our hypothesized direct relationship in H1 and H2 that ruled out the moderating effect of organization size. These analyses did not change the main pattern of results and conclusions, therefore they are not included in the results reported here (for more details, see the Appendix).

11 We have also performed a supplementary regression analysis on the relationship between unethical behavior and ethical awareness (see the Appendix).

TABLE 3.1

Descriptive Statistics and Correlations

Variables	Mean	S.D.	1.	2.	3.	4.	5.	6.	7.	8.	9.	10.	11.
1. Gender	1.31	4.64											
2. Organization size	4.85	2.34	.03										
3. Organization tenure	12.51	11.06	-.18	.31**									
4. Function tenure	4.57	3.11	-.10	.00	.16								
5. Industry tenure	19.85	11.19	-.19	-.02	.47**	.22							
6. Unethical behavior	1.74	.74	.19	.37**	.07	-.15	-.01						
7. Ethical awareness	5.28	.75	-.08	.09	-.03	.15	-.10	-.28*					
8. Formal compliance programs	5.02	.80	.04	.42**	.11	.30*	-.01	-.13	.30*				
9. Informal shared ethical values	6.02	1.01	-.12	.29*	.21	.22	.06	-.39**	.56**	.29*			
10. Position power	2.50	1.14	-.10	.14	-.20	-.05	-.18	.19	.29*	.14	.27*		
11. Personal power	4.40	1.36	-.17	-.13	.00	.10	-.08	.08	.42**	.03	.37**	.43**	

Note: Pearson’s correlation, pairwise comparison, without outliers.

**. Correlation is significant at the 0.01 level (two-tailed).

*. Correlation is significant at the 0.05 level (two-tailed)

Statistical Analyses

To test Hypotheses 1 and 2, we standardized all independent variables following Aiken and West (1991) and conducted two separate Ordinary Least Squared Regressions (OLS) for each of our dependent variables. After entering the control variable, organization size, in step 1, we entered formal compliance programs and informal shared ethical values as our main independent predictors in step 2. To test the mediation Hypotheses 3 and 4, we used Hayes' bootstrapping analysis (2012), and the SPSS macro to test for single mediation relationships. [12]

Hypotheses Testing

Hypothesis 1 and 2 proposed that formal compliance programs and informal shared ethical values, would be negatively related to unethical behavior, and positively related to ethical awareness, respectively (results reported in this order). Table 3.2 (Model 2) shows there was a significant and negative direct relationship between informal shared ethical values and unethical behavior (B = -.23, SE = .10, p = .02, R^2= .27), whereas we found no significant relationship between formal compliance programs and unethical behavior (B= -.14, SE = .09, p = .15, R^2 = .27). Table 3.3 (Model 2) shows that there was a significant and positive relationship between formal compliance programs and ethical awareness (B = .20, SE = .10, p = .05, R^2 = .30), and we also found a significant and positive relationship between informal shared values and ethical awareness (B = .39, SE = .09, p = .00, R^2 = .30). Thus, we found partial support for Hypothesis 1, and full support for Hypothesis 2.

[12] As we hypothesized specific mediating variables for the relationships of formal compliance programs and informal shared ethical values with the dependent variables we deliberately used single mediation analyses. According to Preacher & Hayes (2008) when multiple mediators are involved it would be more precise to also test for these mediators in one model. Therefore, we performed parallel mediation analyses for both formal compliance programs and informal shared ethical values, which confirmed our results from the single mediation analyses (see the Appendix for the parallel mediator analyses).

Hypothesis 3 predicted that compliance officers' position power mediated the relationship between formal compliance programs and unethical behavior and ethical awareness, respectively. The mediation analysis showed no significant indirect relationship through compliance officers' perceived position power regarding the relation of formal compliance programs with unethical behavior (B = .00, SE = .02 , R^2 = .23; *ns*.; CI 95% = -.0187, .0715, N = 45; 5000 re-samples), or with ethical awareness (B = .02, SE = .04, *ns*., R^2 = .24; CI 95% = -.0547, .1263, N = 66; 5000 re-samples). Thus, we found no support for Hypothesis 3.

Hypothesis 4, proposed that compliance officers' personal power mediated the relationship of informal shared ethical values on unethical behavior and ethical awareness, respectively. The mediation analysis showed a significant indirect relationship through compliance officers' perceived personal power for the relations of informal shared ethical values with unethical behavior (B = .11, SE = .06, $p < .05$, R^2= .41; CI 95% = .0202, .2650, N = 49; 5000 re-samples), and ethical awareness (B = .09, SE = .04, $p < .05$, R^2= .35; CI 95%= .0244, .1943, N = 71; 5000 re-samples). Thus, we found support for Hypothesis 4.

TABLE 3.2

Regression Analysis of the Direct and Interaction Effects of Formal Compliance Programs and Informal Shared Ethical Values on Unethical Behavior

Variables	Unethical Behavior		
	Model 1	Model 2	Model 3
Organization Size	.23 (.09)*	.36 (.09)**	.37 (.09)**
Formal Compliance Programs (FCP)		-.14 (.09)	-.18 (.09)†
Informal Shared Ethical Values (ISEV)		-.23 (.10)*	-.19 (.10)†
FCP x ISEV			.18 (.10)†
(Adjusted) R^2	.11*	.27*	.30†

Note: *N* = 44; Two-tailed tests, ***p* < .001, **p* < .05, †*p* < .10. Unstandardized regression effects are reported, and standard errors are noted in parenthesis.

TABLE 3.3

Regression Analysis of the Direct and Interaction Effects of Formal Compliance Programs and Informal Shared Ethical Values on Ethical Awareness

Variables	Ethical Awareness		
	Model 1	Model 2	Model 3
Organization size	.09 (.09)	-.11 (.09)	-.12 (.08)
Formal Compliance Programs (FCP)		.20 (.10)*	.29 (.10)**
Informal Shared Ethical Values (ISEV)		.39 (.09)**	.34 (.09)**
FCP x ISEV			-.34 (.12)**
(Adjusted) R^2	-.00	.30**	.36**

Note: $N = 66$; Two-tailed tests, **$p < .001$, *$p < .05$. Unstandardized regression coefficients are reported, and standard errors are reported in parenthesis.

Exploratory Analysis of Interaction effect

To explore the possible interaction effect of formal compliance programs and informal shared ethical values we calculated their interaction term with standardized variables, and included this in the OLS performed for Hypotheses 1 and 2 as recommended by Aiken and West (1991). After entering the control variable, organization size, in step 1, we entered formal compliance programs and informal shared ethical values as our main independent predictors in step 2, their interaction term was added in step 3. We used simple slope analysis to plot the direct relationship between formal compliance programs and unethical behavior, on the one hand, and ethical awareness, on the other hand, at higher (+1 SD), and lower (-1 SD) levels of informal shared ethical values (Aiken & West, 1991).

Table 3.2 (Model 3) does not show a significant interaction with relation to unethical behavior *(B* = .18, SE = .10, *p* = .09, R^2 = .30). However, Table 3.3 (Model 3), shows a significant and negative interaction with relation to ethical awareness *(B* = -.34, SE = .12, *p* = .01, R^2 = .36). We did, however, decompose the nature of these interaction effects through further simple slope analyses (Aiken & West, 1991). The results indicated that the direct relationships of formal compliance programs with both unethical behavior and ethical awareness, respectively, were significant for lower levels of informal shared ethical values (-1 *SD, for unethical behavior*: *B* = -.32, *SE* = .14, *p* = .03, for *ethical awareness*, *B* = .62, *SE* = .18, *p* = .00), but became non-significant for higher levels of informal shared ethical values (+1 *SD*: for *unethical behavior*, *B* = -.01, *SE* = .12, *p* = .92, for *ethical awareness*, *B* = -.05, *SE* = .13, *p* = .72). Although we do not find, that high levels of both organizational characteristics are associated more strongly with employees ethical decision making, our analysis tentatively suggests that the presence of formal compliance programs can compensate for lower levels of informal shared ethical values. The graphical representations of these relationships, depicted in Figures 3.2 and 3.3, suggest that it does not hurt to have both organizational characteristics present (Podsakoff, MacKenzie, Ahearne, & Bommer, 1995).

FIGURE 3.2

The Interaction Effect of Formal Compliance Programs and Informal Shared Ethical Values on Unethical Behavior

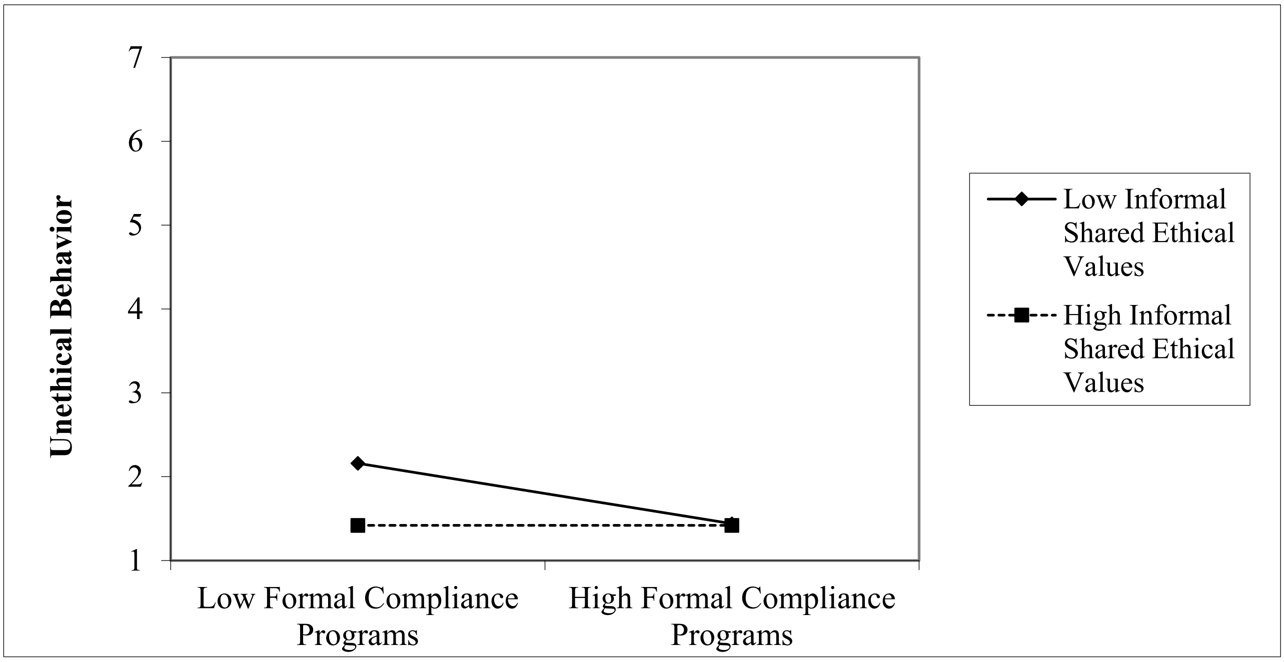
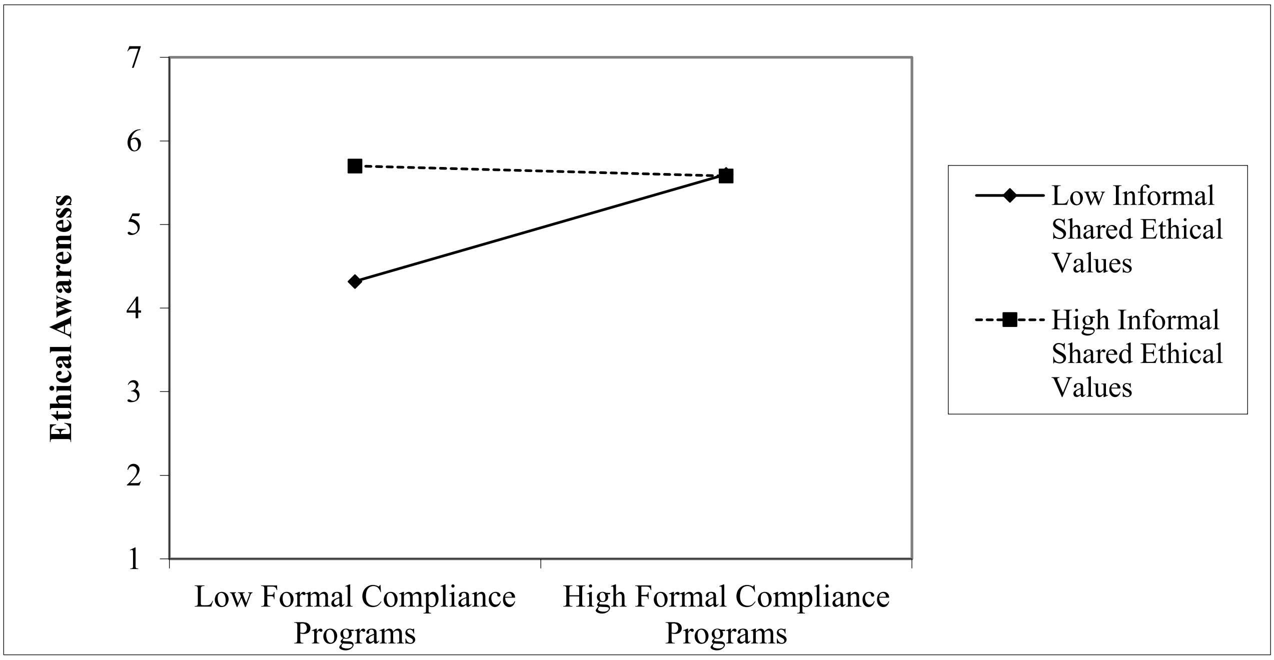


FIGURE 3.3

The Interaction Effect of Formal Compliance Programs and Informal Shared Ethical Values on Ethical Awareness



DISCUSSION

Our field survey among compliance officers examined *how* and *why* formal compliance programs and informal shared ethical values relate to employees' unethical behavior and ethical awareness. We found that formal compliance programs and informal shared ethical values are both negatively related to unethical behavior and positively related to ethical awareness among employees. Additionally, we found that the relationship between informal shared ethical values and employees' unethical behavior and ethical awareness, was mediated by compliance officers' perceived personal power. Contrary to our expectations, the relationship between formal compliance programs and these outcomes was not mediated by compliance officers' perceived position power. Finally, we also explored the possible interaction effect of formal compliance programs and informal shared ethical values in relation to employees' unethical behavior and ethical awareness. We did not find that the combined presence of both organizational characteristics is more strongly related to the outcome variables. Instead, our results showed that formal compliance programs are only significantly related to these outcomes when informal shared ethical values are absent. Our findings thus suggest, that *either* a formal compliance program or informal shared ethical values can be associated with improved ethical decision making by employees.

Theoretical Implications

Our research has two important implications for ethical decision-making and corporate governance literature. First of all, by studying how formal compliance programs and informal shared ethical values together are associated with employees' ethical decision making, our research contributes to previous ethical decision-making literature and gaps in corporate governance research (Dey et al., 2015; Treviño et al., 2014). In line with earlier research, we find that *either* formal compliance programs or informal shared values are associated with these outcomes (e.g., Kaptein, 2011; Kaptein, 2015; Kish-Gephart et al., 2010). In this sense, our findings challenge the idea that the presence of *both* characteristics is a precondition for organizations to effectively influence unethical behavior and ethical awareness (Tenbrunsel et al., 2003; Weaver & Treviño, 1999). In fact, our results tentatively suggest that the combined presence of formal compliance programs and informal shared ethical values is not *more* strongly associated with improved ethical decision making of employees, but that it also does not hurt to have both characteristics present in an organization (Treviño et al., 1999). Moreover, our research suggests that formal compliance programs, designed to promote ethical behavior, can compensate for the absence of informal shared ethical values by serving as the primary ethical guideline in these situations (Kaptein, 2015).

Furthermore, our research contributes to ethics research and corporate governance literature by providing new insights into the role of compliance officers' power bases in relation to employees' unethical behavior and ethical awareness. Surprisingly, our results show that the relationship of formal compliance programs and these outcome variables was not mediated by compliance officers' position power. An explanation could be that formal compliance programs do not elicit explicit perceptions of compliance officers' position power, as compliance officers cannot *immediately* or directly decrease employees' salary, or demote and dismiss employees when compliance rules are violated. Rather, such 'follow through' of compliance programs, by means of disciplinary measures, may lie in the hands of the responsible manager (e.g., Tenbrunsel & Messick, 1999; Treviño & Weaver, 2001).

Our research did reveal that the relationship of informal shared ethical values and employees' unethical behavior and ethical awareness was mediated by compliance officers' perceived personal power. Although ethics scholars have suggested that compliance officers' role and personal power might be related to employees ethical decision making (Treviño et al., 2014), our research is the first to demonstrate this link empirically. In line with research on group prototypicality, our results suggests that compliance officers' self-perceived prototypicality of the informal shared ethical values can give them personal power to influence employees' ethical behavior (Giessner & Van Knippenberg, 2008). Ethics research shows that compliance officers can use such personal power through their interpersonal relationships with employees (Brown, Treviño, & Harrison, 2005; Van Knippenberg, Lossie, & Wilke, 1994). Together, our findings suggest that even when compliance officers lack position power, for instance when no formal compliance program exists, they can gain legitimacy and personal power, through their connection with the informal shared ethical values (Tyler, 2006; Tyler & Blader, 2005).

Strengths, Limitations, and Future Research

The current research has several strengths. First, our sample of professional and experienced compliance officers is a particular strength of this study. By studying the most informed organization members we got accurate information on compliance practices, and their relationship with actual unethical behavior and ethical awareness of employees (Thomas, Clarke, Goia, 1993), rather than employee perceptions (Kaptein, 2015; Treviño et al., 1999; Weaver & Treviño, 1999). With this unique sample, we were also able to study the hypothesized relationships quantitatively, whereas studies up till now mainly studied these relations qualitatively (Treviño et al., 2014). Second, we tested our hypotheses across a wide range of organizations of different size, and by controlling for organization size, we are confident that our results can be generalized to both small and large organizations. Finally, the robustness of our results is enhanced by studying the direct and interactive effect of formal compliance programs and informal shared ethical values in relation to two employee outcomes, namely unethical behavior and ethical awareness (Weaver & Treviño, 1999), whereas previous ethics research has focused on just one of these outcomes (for reviews, see Craft, 2013; O'Fallon & Butterfield, 2005).

However, our research also has some limitations. First of all, as our study was cross-sectional in nature it is not possible to make inferences about causal relationships, and longitudinal research is needed to examine the possible direction of causality. Second, although in this study we deliberately used a sample of compliance officers, we recognize that by relying on a single source to answer our survey measures our results may be vulnerable to common source and method bias. However, the effects of common method bias are limited because it cannot influence the found statistical significant interactions (Podsakoff, Makenzie, & Podsakoff, 2012; Siemsen, Roth, & Oliviera, 2010), and potential common source bias was limited through non-statistical measures as described in the method section (Podsakoff et al., 2012). Nonetheless, a limitation of this sample is that we were only able to measure compliance officers' own perception of their power, whereas our theoretical reasoning and hypotheses focus on the effect of compliance officers' power bases from the perspective of employees. To fully address this latter limitation, future research could combine samples of compliance officers and employees in order to compare perceptions of these groups, especially regarding compliance officers' power bases, to re-examine their effects on the studied relationships. A final limitation could be the used measure of position power adapted from French and Raven (1959, 2001), which blends rewards and sanctions in the same construct, and this might explain why we did not fully capture the deterrence effect of sanctions as predicted in Hypothesis 3. Future research could re-examine the studied relationships with a measure of position power that more clearly distinguishes between rewards and sanctions.

Future research could also examine possible moderators of the studied relationships. For example, regarding the relationship between formal compliance programs and employees' ethical behavior, reward systems and target-setting, as they are considered as important contextual factors (e.g., Treviño et al., 2014). The associated pressures of attaining rewards could have a strong influence on employees' ethical decision making (Murphy, 2004a), for instance it can make employees use shortcuts and act unethically as a result, and this pressure could be further fueled by compliance officers' position power to ultimately influence the rewards of employees. Future research is needed, to create more clarity about how target-setting is related to employees' unethical behavior and ethical awareness (Locke & Latham, 2006; Ordóñez, Schweitzer, Galinsky, & Bazerman, 2009).

Moreover, future research could consider the moderating role of social identification of employees, the degree to which employees define themselves in terms of their association to the organization's values, on the relationship between informal shared ethical values and compliance officers' personal power (Hogg & Van Knippenberg, 2003; Turner, Hogg, Oakes, Reicher, & Wetherell, 1987). After all, it seems highly likely that the influence of prototypical organization members, and thus their personal power, depends on how much employees want to be affiliated with the organizational values that these members represent (Hogg, 2001).

Practical Implications

Our study provides practical insights that can be translated into concrete guidelines for organizations, and in particular for compliance officers, to help improve employees' ethical decision making. Our results suggest that organizations, through managers and compliance officers, can do so by influencing organizational characteristics that are within their control (e.g., Treviño et al., 1998), by *either* implementing a multi-facetted formal compliance program or stimulating that informal ethical values, such as integrity, are shared. It depends on the presence of formal compliance programs and informal shared ethical values which route is most beneficial for a specific organization.

Especially organizations that do not have a formal compliance program yet can benefit from implementing such a program. A multi-facetted formal compliance program is most effective when it encompasses more than just a code of conduct, and also includes training, guidance, communication of the compliance rules, and active enforcement. For instance, by providing training and practical guidance, compliance officers can help employees and managers translate formal compliance rules to daily work practices, and thereby minimizing the risk of decoupling these rules from the core processes of organizations (Maclean & Benham, 2010; Weaver et al., 1999).

Organizations that already have a formal compliance program in place and wish to create an ethical culture could stimulate that informal ethical values, especially integrity, are shared. Our research indicates that most can be gained from communicating the role of compliance officers in terms of role modelling and safeguarding an organizations' integrity, as an important ethical value, next to their traditional formal role of enforcing formal compliance programs. As our findings suggest that such personal power is a potential source of informal influence for compliance officers (Giessner & Van Knippenberg, 2008). Compliance officers can enhance this personal power by actively espousing that they represent integrity as an ethical value and displaying role modelling of desired behavior (Reicher & Hopkins, 2003; Van Knippenberg & Hogg, 2003).

Conclusion

To conclude, our study shows that *either* formal compliance programs or informal shared ethical values, such as integrity, are negatively related to unethical behavior and positively related to ethical awareness among employees. However, we do not find a surplus effect of the combined presence of formal compliance programs and informal shared ethical values in relation to these outcomes. Moreover, we find that the relationship between informal shared values and employees' unethical behavior and ethical awareness can be explained by compliance officers' perceived power. In particular, their power based on personal characteristics (i.e., personal power), rather than power derived from their formal position (i.e., position power), was negatively related to employees' unethical behavior and positively related to their ethical awareness.

APPENDIX

Extra Statistical Analyses (in order of appearance in text)

Extra Analysis on the Relationship between Unethical Behavior and Ethical Awareness

We also tested for the assumption in Rest's model on ethical decision making (1969) that ethical awareness precedes and, ultimately, can influence unethical behavior. A series of OLS regression analyses show that in our study ethical awareness is negatively related to unethical behavior (controlled for organization size), although we only find a moderately significant relationship (B = -.15, SE = .08, p = .06, R^2 = .21). That we do not find a strong direct relationship between these two variables is in line with Rest's model (1969), since ethical awareness may not directly result in changes in unethical behavior as there are two intermediate steps (ethical judgement and intent) before individuals make an ethical decision.

Extra Analysis with Parallel Mediators Perceived Position Power and Personal Power

Following Preacher and Hayes (2008), we performed parallel mediation analysis in which we included both proposed mediators, compliance officers' perceived position and personal power, simultaneously. The relationship of formal compliance programs with unethical behavior and ethical awareness cannot be explained by perceived position power (*unethical behavior*: -.0499, .0242; *ethical awareness*: CI 95% = -.0239, .0940), nor perceived personal power (unethical behavior CI 95% = -.0210, .0992; ethical awareness: CI 95%= -.0346, .1653). The relationship of informal shared ethical values with unethical behavior and ethical awareness is only mediated by perceived personal power (*unethical behavior*: CI 95%= .0141, .2741; *ethical awareness*: CI 95% = .0114, .1962) and not by perceived position power (*unethical behavior*: CI 95% = -.0353, .1115; *ethical awareness* CI 95% = -.0152, .0949). This is consistent with the results of the single mediation analyses reported in this chapter.

Robustness Check of Results including all Control Variables

To further test the robustness of the results, we re-ran the analyses reported in the main body of this chapter including all control variables that were considered theoretically relevant, that is organization size, compliance officers' organization, function or industry tenure, and gender. Notably, most of these control variables were not significantly correlated to the dependent variables (except organization size), and including a large number of control variables especially if they are non-significant may affect statistical power or induce parameter bias estimates (Becker, 2005), therefore these controls are not included in the main reported results.

With all these control variables included we again found a significant and negative direct relationship between informal shared ethical values and unethical behavior (B = -.34, SE = .12, p = .01, R^2= .25), but again we did not find a significant relationship between formal compliance program and unethical behavior (B= -.10, SE = .10, p = .35, R^2 = .25). Moreover, again we found a significant and positive relationship between formal compliance programs and ethical awareness (B = .23, SE = .11, p = .05, R^2 = .26), as well as a significant and positive relationship between informal shared ethical values and ethical awareness (B = .36, SE = .10, p = .00, R^2 = .26). The interaction analysis including all control variable does show a significant interaction of formal compliance programs and informal shared ethical values on unethical behavior (B = .25, SE = .12, p = .04, R^2 = .32), and again for ethical awareness (B = -.32, SE = .14, p = .03, R^2 = .31). So, with all control variable we still find partial support for Hypothesis 1 for formal compliance programs, full support for Hypothesis 2 for informal ethical values, and stronger evidence for the interactive relationships than in the reported results.

The Hayes Bootstrapping macro including all control variables again shows no significant indirect relationship though compliance officers' perceived position power for the relationship between formal compliance program and unethical behavior (*B* = .00, SE = .03 , R^2 = .24; *ns*.; CI 95% = -.0407, .0752, N = 43; 5000 re-samples), and also again not with ethical awareness (*B* = .03, SE = .05, *ns*., R^2 = .27; CI 95% = -.0505, .1395, N = 60; 5000 re-samples). With all control variables included, the mediation analysis does not show a significant indirect relationship through compliance officers' personal power for the relationship between informal shared ethical values and unethical behavior (*B* = .07, SE = .06, *ns*, R^2= .45; CI 95% = -.0156, .2209, N = 45; 5000 re-samples), but it is again significant for ethical awareness (*B* = .07, SE = .04, $p < .05$, R^2= .34; CI 95% = .0077, .1604, N = 62; 5000 re-samples). Hence, also with all these control variables included we find partial support for Hypothesis 4, but still not for Hypothesis 3.

Robustness Check of Results without Control Variables

To further test the robustness of the reported results, we re-ran all analyses reported in the main body of this chapter without organization size as control variable. Without control variables, we found no significant relationship between formal compliance programs and ethical awareness (*B* = .13, SE = .08, $p = .10$, R^2 = .32), but again we found a significant and positive relationship between informal shared ethical values and ethical awareness (*B* = .40, SE = .08, $p = .00$, R^2 = .32). A significant and negative direct relationship between informal shared ethical values and unethical behavior (*B* = -.32, SE = .12, $p = .01$, R^2= .10) was shown again, and also no significant relationship between formal compliance program and unethical behavior appeared (*B*= .00, SE = .10, $p = .98$, R^2 = .10). The interaction analysis without control variables does show a significant interaction of formal compliance programs and informal shared ethical values on unethical behavior (*B* = .26, SE = .13, $p = .05$, R^2 = .16), and again for ethical awareness (*B* = -.29, SE = .10, $p = .01$, R^2 = .38). So, without organization size as control variable we still find full support for Hypothesis 2 for informal shared ethical values, but less support for Hypothesis 1 for formal compliance programs, and stronger evidence for the interaction effects than in the reported results. This outcome for formal compliance programs is not surprising as organization size is found to be related to the presence of multi-facetted compliance programs in organizations (Kaptein, 2015). To rule out the moderating effect of organization size on the presented relationships we have performed an extra analysis (see below).

The Hayes Bootstrapping macro without control variables again shows no significant indirect relationship through compliance officers' perceived position power for the relationship between formal compliance program and unethical behavior (B = .02, SE = .03 , R^2 = .05; *ns*.; CI 95% = -.0114, .1268, N = 49; 5000 re-samples), and again not with ethical awareness (B = .03, SE = .03, *ns*., R^2 = .18; CI 95% = -.0154, .1066, N = 71; 5000 re-samples). The mediation analysis shows a significant indirect relationship though personal power for the relationship between informal shared ethical values and unethical behavior (B = .09, SE = .06, $p < .05$, R^2= .21; CI 95%= .0048, .2150, N = 53; 5000 re-samples), and also for ethical awareness (B = .07, SE = .03, $p < .05$, R^2= .37; CI 95% = .0108, .1438, N = 76; 5000 re-samples). Hence, also without control variables we find full support for Hypothesis 4, but again not for Hypothesis 3.

Extra Analysis with Organization Size as Moderator

Given the above results for the analysis without organization size as control variable we explored a model with organization size as moderator. This makes sense as in previous ethics research organization size is often considered as an important contextual variable in relation to unethical behavior and ethical awareness (Murphy, Smith & Daley, 1992). A series of OLS regression analyses revealed that the three-way interactions (formal compliance program x informal shared ethical values x organization size) on unethical behavior were not significant (lowest *p*-value; $B = -.18$, $p = .13$), and also in relation to ethical awareness there were no significant results (lowest *p*-value; $B = .10$, $p = .25$). Hence, including organization size as moderator did not significantly affect the results reported in this chapter.

Further Confirmatory Factor Analysis

Next to the fit of the entire model, we also assessed 2 alternative models to further evaluate the optimal goodness of fit to our data. However, these two models did not fit the data better than Model 1. Model 2 tested the fit of a five factor model in which the items of our two dependent variables, unethical behavior and ethical awareness, loaded on one single factor. This model yielded a worse fit to the data than model 1 ($X^2 = 952.501$, $df = 454$, $p < .001$, CFI = .56, RMSEA = .12, TLI = .49). Furthermore, we also tested Model 3 which went one step further than model 2 and also included one overarching factor with our two measures for position and personal power, and this yielded a worse fit to the data than Model 1 and 2 ($X^2 = 1022.133$, $df = 485$, $p < .001$, CFI = .50, RMSEA = .13, TLI = .43). Hence, the model described in the chapter fits the data best.

CHAPTER 4

HOW INTERNAL AND EXTERNAL SUPERVISION IMPACT THE DYNAMICS BETWEEN BOARDS AND TOP MANAGEMENT TEAMS AND TMT REFLEXIVITY[13]

ABSTRACT

This chapter examines the link of internal supervision with intergroup conflict, the composition of internal supervisory boards, and Top Management Team (TMT) reflexivity, in relation to external supervision. Reflexivity can prevent TMTs from using decision biases that harm sound decision making. To safeguard such reflexivity TMTs are supervised internally by supervisory boards, and externally by independent supervisory authorities, but there is theoretical debate on their respective impact. We propose that frequent internal supervision is associated with Board-TMT relationship conflict, but this relationship will be less strong when TMTs are supervised by boards with an open board composition (i.e., new members that have entered the board recently). When such conflict occurs it can harm TMT reflexivity, but we expect this relationship to be less strong when external supervision increases. These hypotheses were largely supported by a multisource team-level field survey conducted among 111 TMTs members and 152 members of their internal supervisory boards of 56 insurance companies. This chapter advances empirical knowledge on how contextual factors and behavioral group processes impact and explain the independent effects and interplay of internal and external supervision in relation to sound TMT decision making.

[13] This chapter is based on De Waal, M.M., Veltrop, D.B., Rink, F.A., & Stoker, J.I. (2018). How Internal and External Monitoring Impact Board-TMT Dynamics and TMT Reflexivity. The underlying paper is published as DNB working paper (no. 604), and was also presented at the 7th Biennial conference of the ECPR standing group on regulatory governance in July 2018 in Lausanne, Switzerland.

Scholars and practitioners are in common agreement that reflexivity by Top Management Teams (TMTs) - their ability to critically reflect on their own group functioning and adapt their behavior accordingly (West, 2000) - is necessary for TMTs to fulfill their key responsibilities. That is, to make strategic decisions that serve and protect the interests of all organizational stakeholders and thereby effectively balance the competing interests of these different parties necessary to ensure organizational viability (Aguilera, Desender, Bednar, & Lee, 2015). Due to the challenging and complex circumstances under which TMTs have to make such strategic decisions, for instance causing information overload, these teams become vulnerable to decision biases and more inclined to take shortcuts that lead to less balanced decisions (Boivie, Bednar, Aguilera, & Andrus, 2016; Westphal & Bednar, 2005). For example, TMTs may pursue their own short-term interest rather than the long-term interests of their organizations' stakeholders. Thus, TMTs need to reflect on their own functioning in order to balance these diverging interests and to prevent that such decision biases become habitual routines (Gersick & Hackman, 1990).

To safeguard that TMTs reflect on their decisions, their outcomes are supervised internally, by supervisory boards[14] within their own organization with the main task to monitor whether TMT actions are in the interest of the organization and its stakeholders (Fama & Jensen, 1983; Jensen & Meckling, 1976; Walsh & Seward, 1990), and externally, by independent supervisory institutions with the legal task and authority to monitor whether TMT strategic decisions are compliant with the law and to safeguard stability in the larger

[14] Our study mainly reflects the situation in a two-tier board structure, in which a management board or Top Management Team (TMT, including the CEO) is formally and operationally separated from a supervisory board (Mallin, 2007). For reasons of readability we refer to the two studied management bodies, as the supervisory board (board), respectively, and the Top Management Team (TMT, e.g., Boivie et al., 2016).

This situation is formally different from one-tier board structures where these functions are combined in one management body; the board of directors with executive and non-executive directors (Bezemer, Maassen, van den Bosch, & Volberda, 2007). Despite these formal differences, the main monitoring tasks performed by internal supervisory bodies are similar for both members of supervisory boards and non-executives directors in a board of directors (Mallin, 2007). Hence, when we refer to internal supervision this might refer to the monitoring activities performed by both non-executives in a board of directors and by members of a supervisory board.

system these organizations are part of (e.g., Aguilera et al., 2015). Although the roles of both internal and external supervisory bodies have gained importance in response to the financial crisis (2007-2009) (Wouters & Van Kerckhoven, 2011), there is an ongoing theoretical debate about their effectiveness in influencing TMT functioning.

In the adjacent fields of Economics, Organization Management and Business, this theoretical debate revolves around two streams of Corporate Governance literature that have fundamentally different perspectives on the extent to which internal and external supervision affect TMT reflexivity. One stream of literature builds on agency theory (Jensen & Meckling, 1976), proposing that there are inherent differences between the interests of supervisory boards and TMTs. Therefore in this view, frequent internal and external supervision of TMT decisions is necessary to create alignment between these diverging interests and to prevent TMTs from falling prey to decision biases which make them more inclined to make self-serving decisions (Jensen & Meckling, 1976; Ward, Brown, & Rodrigues, 2009). The other stream of literature builds on stewardship theory (e.g., Donaldson, 1990; Donaldson & Davis, 1991), proposing that the interests of boards and TMTs are already aligned, as both parties are aimed at serving the organization (Davis, Schoorman, & Donaldson, 1997; Donaldson & Davis, 1991). Therefore, from this view, frequent supervision, particularly internal supervision by boards, may merely trigger interpersonal tensions between boards and TMTs (Kellermanns & Eddleston, 2004) that, in turn, can undermine TMTs' motivation to keep their joint organizational interests in mind (Argyris, 1964; Corbetta & Salvato, 2004). In the conflict literature, interpersonal tensions represent 'relationship conflict' (Jehn, 1995), which refers to conflict based on incompatible or conflicting values. This conflict can occur between members of the same group (i.e., intragroup level, Jehn, 1995), or between members of different parties, as is the case here (i.e., intergroup level, De Dreu, 2010). Relationship conflict is indeed found to harm TMT functioning (e.g., De Wit, Greer, & Jehn, 2012), for example TMT reflexivity (Knapp, Dalziel, & Lewis, 2011). This inevitable negative effect of relationship conflict is often attributed to the higher difficulty to resolve such conflict compared to work-related types of conflict (i.e., task or process conflict[15]; De Dreu & Weingart, 2003).

The goal of the current research is to contribute to the above debate and add insights from a third perspective: social identity theory (SIT, Tajfel & Turner, 1979). SIT proposes that people attach great value to group memberships, because they give a clear sense of 'who they are' and provide positive guidance to people's behavior (Tajfel, 1972). Moreover, as groups prescribe clear behavioral norms members often belief that their own group values are superior to those of other groups (Robbins & Krueger, 2005), and want to protect them from criticism by outsiders (Tajfel & Turner, 1986). The following predictions are mainly based on this premise of SIT and will be further elaborated in our theoretical framework below.

Based on this perspective, we propose that the relationship between internal supervision and Board-TMT relationship conflict is influenced by board compositional characteristics, such as team tenure (Pelled & Adler, 1994), but especially by the openness of boards' composition, indicated by the degree of entry of new board members (Haslam & Ellemers, 2005; Ziller, 1965). Specifically, we argue that this relationship should be less strong for relatively open boards than for relatively closed boards, as open boards will have more fluid values and will be more open to differences in values with TMTs than closed boards (e.g., Brewer, 2001; Hogg, 1992; Tajfel, 1972). Importantly, however, we further propose that when Board-TMT relationship conflict does emerge, it will harm TMT reflexivity, and this negative effect can be mitigated when external supervision increases.

15 In this study we focus on the role of (intergroup) relationship conflict between boards and TMTs. However, as boards and TMTs might also experience conflict regarding incompatible goals and differences of opinion about task-related issues (i.e., task conflict, Jehn, 1995) we have included an alternative analysis with Board-TMT task conflict in our model in Appendix 4C. On a final note, as boards and TMTs do not need to coordinate their work together in a two-tier system, the related process conflict (Jehn, 1995) is less relevant for the dynamics between boards and TMTs.

Accordingly, we argue that a legitimate independent third party can then intervene (Ury, Brett, & Goldberg, 1989), and act as a mediator to stimulate TMT reflexivity (e.g., Jehn & Bendersky, 2003; Karambayya, Brett, & Lythe, 1992).

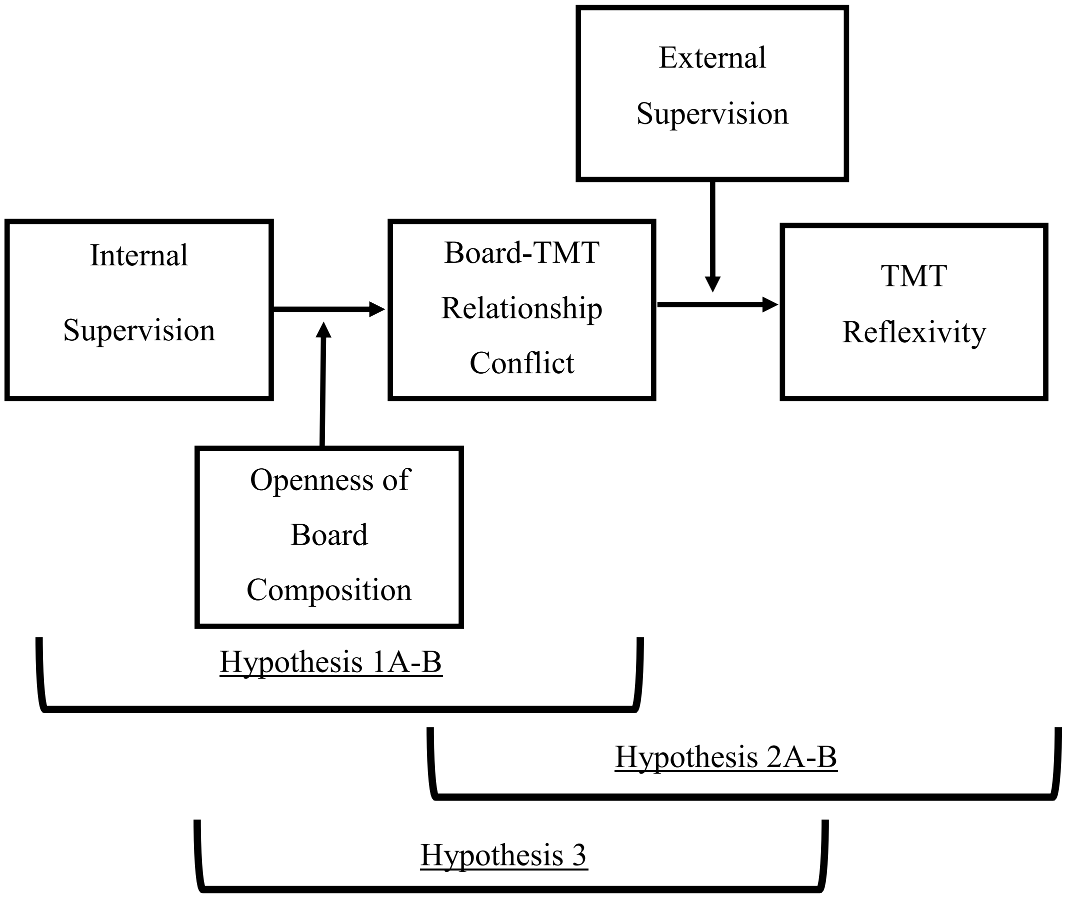
In sum, this chapter presents a conceptual model of *when* and *why* internal and external supervision influence TMT reflexivity. Our central goals are to demonstrate that: a) the relationship between internal supervision and Board-TMT relationship conflict is moderated by the openness of board composition, and in cases where such conflict does arise, that b) the relationship between Board-TMT relationship conflict and TMT reflexivity is moderated by external supervision.

This chapter contributes to existing literature on TMT reflexivity and corporate governance in a number of important ways. First, although it is well conceived that close supervision of TMT decisions by internal and external supervisory bodies is important (Misangyi & Acharya, 2014), there is limited research on the extent to which both supervisory bodies are effective in their roles, and how they affect TMT functioning (Aguilera et al., 2015). Most empirical evidence for the two primary theories in this area, agency theory and stewardship theory, focuses on organizational-level outcomes, such as firm financial performance, and therefore we know very little about the direct impact of supervision on TMT functioning (e.g., Madison, 2014; Rechner & Dalton, 1991; Tosi, Brownlee, Silva, & Katz, 2003). This study is among the first to empirically test the independent effects of internal and external supervision on TMT reflexivity (Aguilera et al., 2015; Walls, Berrone, & Phan, 2012). Second, in order to unravel the debate between agency theory and stewardship theory, we propose to use insights from both conflict research and SIT. This study's explicit focus on the role of Board-TMT relationship conflict as an important underlying mechanism helps to understand how frequent internal supervision by boards may hamper TMT reflexivity (e.g., Jehn, 1995). Third, this study examines earlier neglected contingencies with regard to these relationships, and thereby provides boundary conditions to this debate. We expect that the openness of boards' composition can suppress the negative effect of internal supervision on Board-TMT relationship conflict, and we expect that external supervision can help to mitigate the negative effects of such conflict on TMT reflexivity. Our examination of the role of openness of board composition further adds to corporate governance research on board rotation (e.g., Vafeas, 2003). And, our focus on external supervision in relation to internal supervision shows how the presence of both forms of supervision *together*, and thus their interdependent effects, affect TMT reflexivity (Aguilera et al., 2015).

To test our predictions, we conducted a large field study among insurance companies with headquarters or independent subunits located in the Netherlands and that operated under a two-tier governance system with a separate internal supervisory board and TMT, and all operated under license and external supervision from the Dutch Central Bank. We performed our analysis on the matching and complete team-level data among TMTs (N = 111 TMT members) and their respective supervisory boards (N = 152 board members) of the same insurance companies (N = 56). Our psychological measures were rated by different sources, and this data was subsequently matched with publicly available archival data about supervisory board tenure. In the following sections we introduce our conceptual model with our propositions (see Figure 4.1).

FIGURE 4.1

Conceptual Model



THEORY AND HYPOTHESES

Theoretical Perspectives on Internal Supervision

Agency theory. Agency theory (Jensen & Meckling, 1976) posits that there are inherent differences in interests between the supervisory boards (boards, the 'principal') and Top Management Teams of organizations (TMTs, the 'agent'). Boards act on behalf of key organizational shareholders, or owners, to ensure organizational viability and to safeguard core organizational interests (Eisenhardt, 1989; Fama & Jensen, 1983). From an agency perspective, boards delegate decision-making powers to executives, who make up the TMT (Eisenhardt, 1989). The primary responsibility of TMTs in this view is to make business decisions that ensure sales growth, investment profits, and thus, deliver shareholder value (Fama & Jensen, 1983). According to agency theory, TMTs are immanently less committed to long-term organization interests than their boards and are therefore inclined to make decisions that yield short-term personal results, rather than collective benefits for the organization (Eisenhardt, 1989).

The proposed solution for boards to deal with this so-called “agency problem” and to align the diverging interests between boards and TMTs, is to supervise the actions of TMTs closely (Jensen & Meckling, 1976). This *internal supervision* entails a systematic evaluation of the content and results of TMT strategic decisions (Boivie et al., 2016; McDonald & Westphal, 2010), and specifies what TMT decision-making procedures should be used (McCubbins, Noll, & Weingast, 1989). Boards perform this internal supervision by challenging, questioning and discussing TMT proposals. In this way they hold TMTs accountable for their actions (Roberts, McNulty, & Stiles, 2005), and prevent TMTs from falling prey to decision biases (Jensen & Meckling, 1976).

Empirical evidence confirms that TMTs tend to suffer from decision biases that can harm organizational interests in the long term (Brauer, 2013). They are, for example, influenced by financial incentives that are found to motivate self-interested behavior and enhance self-serving TMT decisions (e.g., Frank & Obloj, 2014). Moreover, several studies suggest that internal supervision can prevent TMTs from using such decision biases, as it reduces their self-serving behavior in organizational decision dilemmas (Kosnik & Bettenhausen, 1992; Madison, 2014; Pitesa & Thau, 2013), and enhances the number of TMT investments that increase organizational profit growth (Tosi et al., 2003). So, there is some support for the agency theory principle that close internal supervision by boards of TMTs’ strategic decisions prevent TMTs from using decision biases, and ultimately that the diverging interests of boards and TMTs will be more aligned.

Stewardship theory. In response to agency theory, stewardship theory (e.g., Donaldson, 1990; Donaldson & Davis, 1991) represents a fundamentally different perspective on how internal supervision impacts the dynamic interplay between boards and TMTs. According to this perspective, both groups are motivated to serve the *same* interests, as TMTs are seen as “organizational stewards” who are, like boards, highly motivated and committed to achieve the collective interests of the organization above their personal interests (Davis et al., 1997; Donaldson & Davis, 1991). Scholars in this domain propose that achieving collective interests, such as organizational growth or increased revenues, drives TMT decisions because it represents an important intangible reward to them (Davis et al., 1997). Given the fact that common interests are best served when TMTs work in good harmony with the relevant stakeholders of their organization, boards should maintain good relations with TMTs (Davis et al., 1997; Donaldson & Davis, 1991). Boards can do so primarily by giving TMTs the autonomy to perform their responsibilities, and support them with a strategic partnership, meaning that they provide guidance and advice for TMTs *future* decision making rather than supervise their current and past actions (Anderson, Melanson, & Maly, 2007; Sundaramurthy & Lewis, 2003).

Following this line of reasoning, scholars in this domain have argued that frequent internal supervision by boards of TMT decisions may actually do more harm than good, as it could create interpersonal tensions between boards and TMTs (Kellermanns & Eddleston, 2004). It has been proposed that such internal supervision, for example, could decrease TMTs’ motivation to make decisions that are not in the organizational interest (Argyris, 1964; Corbetta & Salvato, 2004), diminish the perceived decision-making discretion of TMTs (Davis et al., 1997), and enhance TMT’s skepticism of how boards view their functioning (Frey, 1993).

Research indeed suggests that frequent internal supervision can harm the good working relationship between boards and TMTs, evidenced by, for example, dysfunctional TMT responses such as lowered work effort (Dickinson & Villeval, 2008), due to higher perceived distrust of the board (Falk & Kosfeld, 2006), and heightened interpersonal tensions between both parties (Eddleston & Kellermanns, 2007; Menon, Bharadwaj, & Howell, 1996). Thus, there is also some evidence for the proposition of stewardship theory that frequent internal supervision can lead to relational conflict between boards and TMTs.

Social identity theory. To help solve the debate between agency and stewardship theory, several scholars call for a more integrative theoretical approach to study the effectiveness of internal supervision that also takes the dynamics between boards and TMTs into account (e.g., Aguilera et al., 2015; Walls et al., 2012). In this regard, governance literature has turned to SIT (Tajfel & Turner, 1979), which helps to explain the impact of supervision on underlying group processes within, and between these parties (e.g., Hillman, Nicholson, & Shropshire, 2008). A central premise of this theory is that people attach great value to group memberships, because they give a clear sense of 'who they are' or 'what they stand for' and provide positive guidance and meaning to people's behavior (Tajfel, 1972). As groups tend to prescribe clear norms on what is considered appropriate and valuable behavior, members often belief that their own group values are superior to those of other groups (Robbins & Krueger, 2005), and want to protect their group's values against the (potential) influence, or criticism of outsiders (Tajfel & Turner, 1986). These so-called identity processes are so pervasive that they also occur among groups within the same organization (Labianca, Brass & Gray, 1998), and can cause interpersonal tensions among these groups. That is, both parties will perceive that there are value and personal incompatibilities between members of the two groups (i.e., relationship conflict at the intergroup level, De Dreu, 2010).

Following the above reasoning based on SIT, it seems likely that frequent internal supervision by boards of TMTs signals that there are value differences between both parties and that a board has a critical attitude towards a TMT, and such differences may create Board-TMT relationship conflict (Brewer, 2001; Doosje, Ellemers, & Spears, 1999). So, while agency theory and SIT both predict that there are inherent differences of interests or values between boards and TMTs, each theory grounds this prediction on fundamentally different principles about group behavior and consequently also disagree on how to align these different group interests (Davis et al., 1997). Interestingly, however, SIT also does not fully align with stewardship theory. As stewardship theory believes that both groups share the same organizational values (Davis et al., 1997), and SIT predicts that boards and TMTs, being two different parties, will hold different values and interests, in spite of representing the same organization (Robbins & Krueger, 2005). At the same time, however, based on both SIT and stewardship theory, it can be predicted that frequent internal supervision will most likely do more harm than good as it can either emphasize pre-existing value differences (Brewer, 2001) or breach relatively good interpersonal relationships (Davis et al., 1997), which may both result in relationship conflict. Hence, our first hypothesis is:

Hypothesis 1A: There is a positive relationship between internal supervision and Board-TMT relationship conflict.

The Moderating Role of the Openness of Board Composition

Given the complexity of the above relationship, however, we propose that internal supervision may not lead to relationship conflict between boards and TMTs under all circumstances. Several scholars suggest that Board-TMT relations and conflicts are likely to be influenced by board compositional features, such as team tenure (Pelled & Adler, 1994), the education levels of board members (Hambrick, Li, Xin, & Tsui, 2001), and their collective values (Jehn, Chadwick, & Thatcher, 1997). Accordingly, we propose that the openness of boards' composition is a crucial variable that moderates the relationship between internal supervision and intergroup conflict (Haslam & Ellemers, 2005). The openness of a board refers to the degree to which new members have entered the group recently (Ziller, 1965), indicated by the lowest tenure held by individual members within the board (Hollenbeck, DeRue, & Guzzo, 2004).

Our proposition can also be derived from SIT, as this perspective holds that a group's inward focus should become stronger over time when groups work together longer (Tajfel, 1972). Research in this area confirms that when a group's composition remains relatively stable, members become more familiarized with each other (Harrison, Price, Gavin, & Florey, 2002), they develop strong common group values (Jehn, 1994; Katz, 1982), and become more committed to these values (Ellemers, De Gilder, & Haslam, 2004). Moreover, following SIT, groups also expect other groups to develop such strong shared group values (Crump, Hamilton, Sherman, Lickel, & Thakkar, 2010), and assume that these values will be different from their own (Robbins & Krueger, 2005). In closed groups, these perceived value differences are likely to be greater, as they have less influx of new members from the outside world to contrast these beliefs than open groups. This reasoning is supported by scholars who argue that closed groups are usually less open to new or different ideas and more critical towards outsiders than open groups (e.g., Hogg, 1992; Hornsey & Imani, 2004).

Building upon this line of reasoning, research suggests that the openness of a group's composition will influence the presence of relationship conflict between two parties. For instance, studies have shown that when relatively open groups interact with other groups and there are less value differences, open groups are less skeptical and hold more positive expectations about each other's intentions than relatively closed groups (Insko, Schopler, Hoyle, Dardis, & Graetz, 1990; Petersen, Dietz, & Frey, 2004). Moreover, relatively open groups tend to perceive the actions of other groups less negatively than more closed groups (Dunbar, Saiz, Stella, & Saez, 2000), and generally act more constructively towards these groups (Schwartz, Struch, & Bilsky, 1990). Hence, the openness of a group's composition impacts the relations with another group because it enhances perceptions of value similarity *within* the group and perceptions of value divergence with *other* groups.

Now we will translate these theoretical insights from SIT and related findings specifically to internal supervision by boards of TMTs' decision making. Hence, it can be expected that in a relatively open board composition, where new board members have entered recently, boards will have more fluid values (Moreland & Levine, 2002; O'Reilly, Caldwell, & Barnett, 1989), and will experience less value differences with TMTs (Arrow & McGrath, 1993). Accordingly, only when boards with a relatively closed composition perform internal supervision it may be perceived as too critical of TMT values and signal value differences with TMTs, and hence lead to increased Board-TMT relational conflict (Hambrick et al., 2001; Hornsey & Imani, 2004). When, however, boards have a relatively open composition, their outward supervision actions will reveal less value differences, and Board-TMT relational conflict will be less likely (Rokeach & Regan, 1980). Our hypothesis therefore states:

Hypothesis 1B: The openness of board composition moderates the positive relationship between internal supervision and Board-TMT relationship conflict, such that this relationship becomes less strong when board composition is more open.

Intergroup Relationship Conflict and TMT Reflexivity

Hypotheses 1A and 1B stipulate that internal supervision is associated with Board-TMT relationship conflict, and that the openness of board composition is an important board compositional characteristic that moderates this relationship. But how detrimental is such relational conflict between boards and TMTs for TMT reflexivity? Again following SIT, typical group responses to intergroup conflict include not only actions that show negative skepticism towards the *other* group (Biernat, Vescio, & Theno, 1996; Riek, Mania, & Gaertner, 2006; Tajfel & Turner, 1986), but also involve actions that are in favor of the *own* group (Gaertner & Schopler, 1998; Tajfel & Turner, 1979). Such actions imply that group members evaluate their own group's values even more positively (Stephan, Ybarra, & Morrison, 2009), and demonstrate even greater group loyalty (Ellemers, Spears, & Doosje, 2002). This implies that if Board-TMT relationship conflict arises, TMTs will be more likely to process information in their own favor (Staw, Sandelands, & Dutton, 1981). Consequently, TMTs will be less reflective, due to a reduced willingness to acknowledge mistakes, to discuss improvements or to adapt to future work challenges (Knapp et al., 2011).

Research supports our reasoning, and demonstrates that when groups experience relationship conflict with another party they are more likely to evaluate their own functioning more positively (Balliet, Wu, & De Dreu, 2014). Moreover, research shows that in these situations groups are less tolerant for criticism (Eidelman, Silvia, & Biernat, 2006), and will also display more close mindedness (Golec & Federico, 2004). Together these outcomes indicate that Board-TMT relationship conflict will hamper essential elements of TMT reflexivity (West, 2001). Our hypothesis is therefore:

Hypothesis 2A: There is a negative relationship between Board-TMT relationship conflict and TMT reflexivity.

The Moderating Role of External Supervision

Hitherto, our reasoning revolved around the impact of internal supervision on Board-TMT relationship conflict in relation to TMT reflexivity. However, governance theorists argue that internal and external supervision are *both* important to safeguard reflexivity, such that TMTs make strategic decisions that protect stakeholder interests and safeguard long-term organizational viability (Aguilera et al., 2015). Internal supervisory bodies provide direct supervision over these decisions (Jensen & Meckling, 1976; Walsh & Seward, 1990), and external supervisory bodies supervise and enforce compliance of these decisions with regulation (e.g., Aguilera et al., 2015; Wouters & Van Kerckhoven, 2011). We therefore also examined how external supervision affects the relationship between Board-TMT relationship conflict and TMT reflexivity. Our conceptual model proposes that when the relationship between boards and TMTs becomes strained, external supervisory bodies can intervene as an independent party, to mitigate that the persistence of this conflict will harm TMT reflexivity (Peterson & Behfar, 2003; Widmer, Schippers, & West, 2009). Hence, we argue that the relationship between Board-TMT relationship conflict and TMT reflexivity will be moderated by external supervision.

Our proposition is supported by conflict literature, stipulating that generally speaking, the negative effects of intergroup conflict can be mitigated when a nonpartisan third-party intervenes and acts as a mediator between the two conflicting parties (Dixon, 1996; Jehn & Bendersky, 2003). External supervisory bodies can fulfil this role because they have the legitimate intervention authority (Karambayya et al., 1992; Keashley & Newberry, 1995), and the legal instruments to step in when TMT functioning endangers organizational sustainability and/or risks the stability of a larger industry (Ury et al., 1989; Wouters & Van Kerckhoven, 2011). Third-party conflict interventions are most effective when they facilitate a dialogue between the two conflicting parties, but leave the responsibility and control over the process for resolving the conflict to the respective parties (Carnevale & Pruitt, 1992; Karambayya et al., 1992). In order to mitigate the effects of Board-TMT relationship conflict, external supervision interventions can be focused on reflexivity and providing feedback on TMT performance (Gurtner, Tschan, Semmer, & Nägele, 2007).

There is empirical evidence in support of this notion, which shows that groups experiencing conflict with another party engage in more reflexivity after a third-party intervention than when no such intervention took place (Tjosvold, Hui, & Yu, 2003; Weinberg-Kurnik, Nadan, & Ben Ari, 2015), especially if the third party had legitimate authority (Keashley & Newberry, 1995). The effect on reflexivity was highest, if the intervention was focused explicitly on reflexivity *and* included providing performance feedback (Gabelica, Van den Bossche, De Maeyer, Segers, & Gijselaers, 2014; Konradt, Schippers, Garbers, & Steenfatt, 2015). Accordingly, we hypothesize:

Hypothesis 2B: External supervision moderates the negative relationship between Board-TMT relationship conflict and TMT reflexivity, such that this relationship becomes less strong when external supervision increases.

Our Combined Conceptual Model

Thus far, we predict that there is a positive relationship between internal supervision and Board-TMT relationship conflict (Hypothesis 1A), but that a more open composition of boards, indicated by a higher degree of new members entering the board (i.e., the openness of board composition), makes this relationship less strong (Hypothesis 1B). We subsequently predicted that in cases where relational conflict between boards and TMTs emerges, it negatively relates to TMT reflexivity (Hypothesis 2A). We also proposed, that under these circumstances, increased external supervision mitigates this indirect effect (Hypothesis 2B). Our combined conceptual model (see Figure 4.1.) implies that the relationship between internal supervision and TMT reflexivity is explained through Board-TMT relationship conflict, and that this indirect effect is conditional on the openness of boards' composition and on external supervision.

Together, these predictions represent a moderated mediation pattern, which is reflected in our final hypothesis:

Hypothesis 3: Internal supervision is directly positively related to Board-TMT relationship conflict and indirectly negatively related to TMT reflexivity. This relationship is conditional on the openness of board composition, and the indirect link with TMT reflexivity is conditional on external supervision.

METHOD

Sample and Procedure

Our research was conducted in 2014 among a sample of supervisory boards (boards) and Top Management Teams (TMTs) of Dutch insurance companies. To ensure a maximum response rate and limit social desirability we followed several recruitment procedures recommended by, for instance Westphal and Stern (2007), such as using personal communication and endorsements (i.e., from the Dutch Association of Insurance Companies, VVV[16]), guaranteeing anonymous and confidential treatment of the data. Given the fact that the survey was sent to boards and TMTs of insurance companies by the De Nederlandsche Bank (DNB), the external supervisory body, it was further emphasized that the data would not be available or useable for direct supervision of insurance companies by DNB. Moreover, to highlight the independence of this research, the survey was sent by the head of the research department of DNB. Finally, in return for their participation, each board and TMT received a report benchmarking their survey scores against the total sample.

At the time of data collection, there were 290 insurance companies active in the Netherlands that operated under license and external supervision from DNB. Together, these

[16] The VVV represents the interest of the majority of insurance companies, and together their members hold more than 95% of the market share in the Netherlands.

companies hold 75 billion in gross premium income and employed 52.000 people[17]. After consultation with the insurance supervision department of DNB, we approached 135 insurance companies to participate in our study which were under external supervision by DNB and had a separate internal supervisory board and TMT and accordingly fulfilled the following criteria[18]; 1) they have headquarters located in the Netherlands, or, 2) they are independent subunits (i.e., separate entities belonging to an insurance group holding) that are governed by autonomous internal supervisory boards and TMTs and did not fall under the direct control of the holding. We sent surveys to all TMT members (N = 245) and all supervisory board members (N = 408) of these insurance companies. From the approached TMTs, 52% of the members (N = 128) of 65 TMTs completed and returned the survey. From the approached boards, 47% of the members (N = 193) from 76 boards participated in our study. However, in order to perform our analyses we needed participation from supervisory board members as well as TMT members of the same insurance company. All in all, we had a response from 56 companies of which the TMT and the supervisory board both participated. As a result, our final sample consisted of 111 TMT members (M_{age} = 52.70, SD = 7.89, 7% female), and 152 board members (M_{age} = 58.86, SD = 8.15, 14.5% female) from 56 organizations.

To assess the representativeness of our final sample, we conducted a Kolmogorov-Smirnov two-sample test (see Westphal & Bednar, 2005), and tested whether the distributions of key characteristics from the TMTs and boards included in our sample (i.e., their sizes, average member tenure in years and their member age) were comparable with the

17 https://www.verzekeraars.nl/verzekeringsbranche/cijfers/Documents/KerncijfersVerzekerenInNederland/2014/2190-VVV-Kerncijfers%202014-NL-v2-web.pdf

18 When the headquarters of the insurance company is located in the Netherlands then the institution falls under direct home supervision of DNB as the primary external supervisory body. Moreover, for this study it is important that supervisory boards and TMTs have discretionary powers over the company or subunit and can make decisions independently from the management body of a larger holding company, and therefore we have only selected organizations that have a separate and independent governance structure.

distributions of those same characteristics for boards and TMTs that were not included in the final sample (i.e., those that did not respond to our survey or those that were excluded in the sample on the basis of missing data). The results showed that our participating boards and TMTs did not differ from the non-participating boards and TMTs, in terms of size, average tenure and age (*p*-values for TMTs were respectively .74, .85, .39; *p*-values for boards .86, .34, .43, respectively).

Measurement

To avoid common source bias (Podsakoff & Organ, 1986) we assessed our measures through multiple sources, such that our independent measures were rated by supervisory board members and our dependent measure was rated by TMT members. The key independent variable (i.e., internal supervision) was rated by supervisory board members, the first moderator (i.e., openness of board composition) was obtained from archival data, the second moderator (i.e., external supervision) was also rated by supervisory board members, as was the central mediating mechanism in our model (i.e., Board-TMT relationship conflict), and finally our dependent variable (i.e., TMT reflexivity) was rated by members of the TMTs. For an overview of the different data sources used for each variable, see Table 4.1.

Furthermore, our theory refers to the team level of analysis. We therefore used a referent shift informant sampling approach to gather data by framing all items at the team level (e.g., Van Der Vegt & Bunderson, 2005). This approach allowed that different members of a particular TMT, and different members of a particular board were qualified to provide ratings on TMT or board-level properties (e.g., Simons, Pelled, & Smith, 1999). So, for example, we asked all TMT members to evaluate the reflexivity of their TMT as a whole, rather than to report their own personal level of reflexivity. For each of our measures, we subsequently calculated the $r_{wg(j)}$ inter-agreement coefficient for multi-item indices, and we compared the $r_{wg(j)}$ to uniform and a highly skewed distributions as recommended by James and colleagues (James, Demaree, & Wolf, 1984; James, Demaree, & Wolf, 1993; see also LeBreton & Senter, 2008). We also calculated the intra-class correlation coefficient (ICC_1) to determine whether data aggregation to the team level was accurate and that teams differed significantly in their ratings (Bliese, 2000). These $r_{wg(j)}$ values and ICC_1 scores are reported per measure below. All survey items are listed in Appendix 4A.

TABLE 4.1

Data Source per Study Variable

Measure	Variable	Rated by TMT members	Rated by supervisory board members	Archival data
Internal Supervision	Independent variable		X	
Openness of Board Composition	Moderator			X
Board-TMT Relationship Conflict	Mediator		X	
External Supervision	Moderator		X	
TMT Reflexivity	Dependent variable	X		

Measures

Internal Supervision. The core task of internal supervision, by supervisory boards, is to monitor whether TMT decisions and activities are in the interest of the organization and its stakeholders (Boivie et al, 2016; McDonald & Westphal, 2010), therefore we have measured internal supervision in terms of this monitoring activity. Internal supervision was assessed with three items adapted from McDonald and Westphal (2010, e.g., “To what extent does the supervisory board monitor the strategic decision making of the top management team?"), rated by board members on a 7-point scale (1 = *to a very small degree*, 7 = *to a very large degree*), and these items formed a reliable scale (α = .72). The $r_{wg(j)}$ and ICC_1 statistics indicated that the data can be aggregated to the team-level (ICC_1 = .22, p <.001; compared to a uniform distribution, median $r_{wg(j)}$ = .95, mean = .89; compared to a highly skewed distribution, median $r_{wg(j)}$ = .85, mean = .82).

Openness of Board Composition. The openness of board composition, the degree of entry of new members in a supervisory board, is generally measured by using the organizational tenure in years of individual members (e.g., Gundry, 1993; Morrison & Vancouver, 2000; Ziller, Behringer, & James. 1961), and its average is used to indicate membership changes or turnover in teams (Keck, 1997; Van der Vegt, Bunderson, & Kuipers, 2010). However, these measures are criticized by scholars, as they treat the openness of boards' composition as an absolute group-level trait (Hollenbeck et al., 2004), and do not accurately reflect the tenure of the *newest* members that have entered the team relative to other members (Rollag, 2004). For example, teams with similar mean tenure values can have diverging team compositions (i.e., they may consist of members that vary greatly in tenure, or, of members with similar, medium, levels of tenure). We therefore based our measure of the openness of board composition on board members' *minimum* tenure (see Hollenbeck et al., 2004), as the board member with the lowest tenure reflects better how recent the *newest* member has entered the board. Thus in the current study, higher minimum tenure indicated a more closed board composition, where no new members have entered the board recently, whereas lower minimum tenure indicated a more open board composition, where a new member has entered the board more recently.

Board-TMT Relationship Conflict. Board-TMT relationship conflict was measured with three items adapted from Jehn and Mannix (2001, e.g., "How much relationship tension is there between the Top Management Team and the supervisory board"). Board members rated these items on a 7-point scale (1 = *never*, 7 = *very often*), and together these items formed a reliable scale ($\alpha = .82$). The $r_{wg(j)}$ and ICC_1 statistics warranted that the data could be aggregated to the team-level ($ICC_1 = .58$, $p < .001$; compared to a uniform distribution, median $r_{wg(j)} = .97$, mean = .91; compared to a highly skewed distribution, median $r_{wg(j)} = .92$, mean = .74).

External Supervision. The core task of external supervision, by independent supervisory authorities, is to monitor whether TMT decisions and activities are in line with formal regulation (Palmer & Cerruti, 2009; Sijbrand & Rijsbergen, 2013), therefore we have measured external supervision in terms of this monitoring activity. Similar to the items used for internal supervision, external supervision was assessed with three adapted items from McDonald and Westphal (2010), and together these items formed a reliable scale (e.g., "To what extent does DNB[19] monitor the strategic decision making of the top management team"; 1 = *to a very small degree*, 7 = t*o a very large degree;* $\alpha = .64$). The $r_{wg(j)}$ and ICC_1 statistics warranted that the data could be aggregated to the team-level ($ICC_1 = .32$, $p < .001$; compared to a uniform distribution, median $r_{wg(j)} = .81$, mean = .93; compared to a highly skewed distribution, median $r_{wg(j)} = .90$, mean = .61).

TMT Reflexivity. TMT reflexivity is inherently an emerging group process within TMTs (Schippers, Den Hartog, Koopman, & Wienk, 2003), therefore we used TMT ratings for this measure. TMT members rated eight items adapted from Schippers and colleagues (Schippers, Den Hartog, & Koopman, 2007; Schippers, Den Hartog, Koopman, & Van Knippenberg, 2008; see also Swift & West, 1998, e.g., "We regularly discuss whether the top management team is working together effectively", 1 = *strongly disagree*, 7 = *strongly agree*),

[19] In the Netherlands, De Nederlandsche Bank (DNB) is the prudential external supervisory body that monitors the actions of insurance companies and their TMTs.

and these items formed a reliable scale (α = .80). The $r_{wg(j)}$ and ICC_1 statistics warranted that the data could be aggregated to the team-level (ICC_1 = .22, p < .001; compared to a uniform distribution, median $r_{wg(j)}$ = .92, mean = .91; compared to a highly skewed distribution, median $r_{wg(j)}$ = .89, mean = .54).

Control Variables. Given that our mediator, Board-TMT relationship conflict, is an inter-team construct, we considered characteristics of supervisory boards as well as TMTs and included them as control variables. The following control variables have been found to influence TMTs processes and/or Board-TMT interactions in previous research: a) group size (e.g., Bucholtz, Amason, & Rutherford, 2005; Tuggle, Simon, Reutzel, & Bierman, 2010), because larger teams are more prone to experience communication problems that may hamper TMT reflexivity (e.g., Blau, 1970; Haleblian & Finkelstein, 1993); b) age diversity, because this is known to impact team reflexivity and can give rise to intergroup conflict (Armstrong, Flood, Guthrie, Liu, MacCurtain, & Mkamwa, 2010; West, Paterson, & Dawson, 1999); c) the proportion of female members in teams (Hillman, Shropshire, Certo, Dalton, & Dalton, 2011), since gender diversity has also been related to dissenting opinions, which can positively impact reflexivity within a team (e.g., De Dreu & West, 2001; Nijstad, Berger-Selman, & De Dreu, 2014), but can also create conflict between teams (e.g., Li & Hambrick, 2005); and d) openness of TMT composition[20], as groups with a more open composition are found to develop more creative work ideas, and hence, this may affect TMT reflexivity (Choi & Thompson, 2005; Schippers et al., 2003).

[20] We mention openness of TMT composition as a control variable here (measured by minimum TMT tenure), as we expect it to affect our dependent variable TMT reflexivity (e.g., Choi & Thompson, 2005) directly, rather than through Board-TMT relationship conflict. Therefore, we did not include this variable as a moderator in our conceptual model, because we did not expect it to have a strong (moderating) effect on the relationship between internal supervision and Board-TMT relationship conflict. Specifically, we expect this relationship to be influenced more strongly by the openness of the composition of the group, the board, *providing* the supervisory feedback of TMTs actions as this may impact whether this activity is perceived as critical by TMTs (see our theoretical section for a more elaborate explanation of this moderating effect), and less so due to openness of the composition of the group, TMTs, *receiving* internal supervision by the board.

RESULTS

Descriptive Statistics

Table 4.2 presents the means, standard deviations, and Pearson zero-order correlations for all study variables. None of the control variables were significantly related to our mediator, Board-TMT relationship conflict, or our dependent variable, TMT reflexivity (see Appendix 4B). To avoid biased parameter estimates we therefore excluded all controls from further analysis (Becker, 2005). [21]

TABLE 4.2

Means, Standard Deviations, and Correlations for Study Variables

	Variables	Mean	S.D.	1	2	3	4
1	Internal supervision	5.24	0.76				
2	Openness of Board Composition	2.29	1.83	-.32*			
3	Board-TMT relationship conflict	1.73	0.65	.15	.29*		
4	External supervision	4.16	1.07	.36**	-.10	.23†	
5	TMT reflexivity	4.92	0.74	.13	-.01	-.10	.04

N = 56. †p <.10, *p < .05, **p < .01.

Statistical analyses

To test hypotheses 1 A-B and 2 A-B at the team level of analysis we used ordinary least square (OLS) regressions. We used standardized variables for our analyses and to calculate our interaction terms (Aiken & West, 1991). In our OLS regression analyses, Model 1 includes the independent predictors, and in Model 2 we included their interaction term

21 There was no correlation between the control variable openness of TMT composition and TMT reflexivity. Therefore, for statistical reasons (Becker, 2005) we excluded this variable as control variable, similar to the other control variables, from our analyses and the results of our hypotheses reported in this chapter. Notably, including openness of TMT composition as control variable in the analyses did not significantly change the pattern of results (see Appendix 4C).

(Aiken & West, 1991). In the analysis for Hypothesis 2B we also included the independent variables of Hypothesis 1, internal supervision and openness of board composition, as extra control variables in Model 1. To test our moderated mediation model proposed in Hypothesis 3 we used Hayes' (2012) bootstrapping analysis for conditional indirect effects (Preacher, Rucker, & Hayes, 2007)[22], for which the bootstrap 95% confidence intervals were estimated at higher (+1 *SD*), intermediate (*Mean*) and lower (-1 *SD*) levels of openness of board composition and external supervision.

Hypotheses Testing

Hypothesis 1A predicted that internal supervision was positively related to Board-TMT relationship conflict, and Hypothesis 1B predicted that this relationship was moderated by the openness of board composition, such that this relationship became less strong when board composition was more open. Consistent with Hypothesis 1A, Table 4.3 (Model 1) shows a significant and positive direct relationship between internal supervision and Board-TMT relationship conflict (β = .27, p = .02, R^2 = 0.15). Hence, Hypothesis 1A was supported. Consistent with Hypothesis 1B, Table 4.3 (Model 2) shows a significant and positive interaction effect of openness of board composition and internal supervision on Board-TMT relationship conflict (β = .26, p = .04, R^2 = .20). Simple slope analyses (Aiken & West, 1991) further confirmed the prediction of Hypothesis 1B, that internal supervision was significantly stronger and positively related to Board-TMT relationship conflict, when board composition was more closed, indicated by higher minimum board tenure (+1 *SD*: β = .28, *SE* = .11, p = .00). This relationship indeed became non-significant and weaker when board composition was more open, indicated by lower minimum board tenure (-1 *SD*: β = .01, *SE* = .17, p = .47).

[22] This procedure resolves conceptual and methodological limitations of traditional mediation analysis and allows for multiple moderators to be entered in the analysis (Preacher & Hayes, 2004; Preacher, Rucker, & Hayes, 2007)

This pattern of results is illustrated in Figure 4.2. Taken together, we found support for Hypothesis 1B.

TABLE 4.3

Regression Results Board-TMT Relationship Conflict

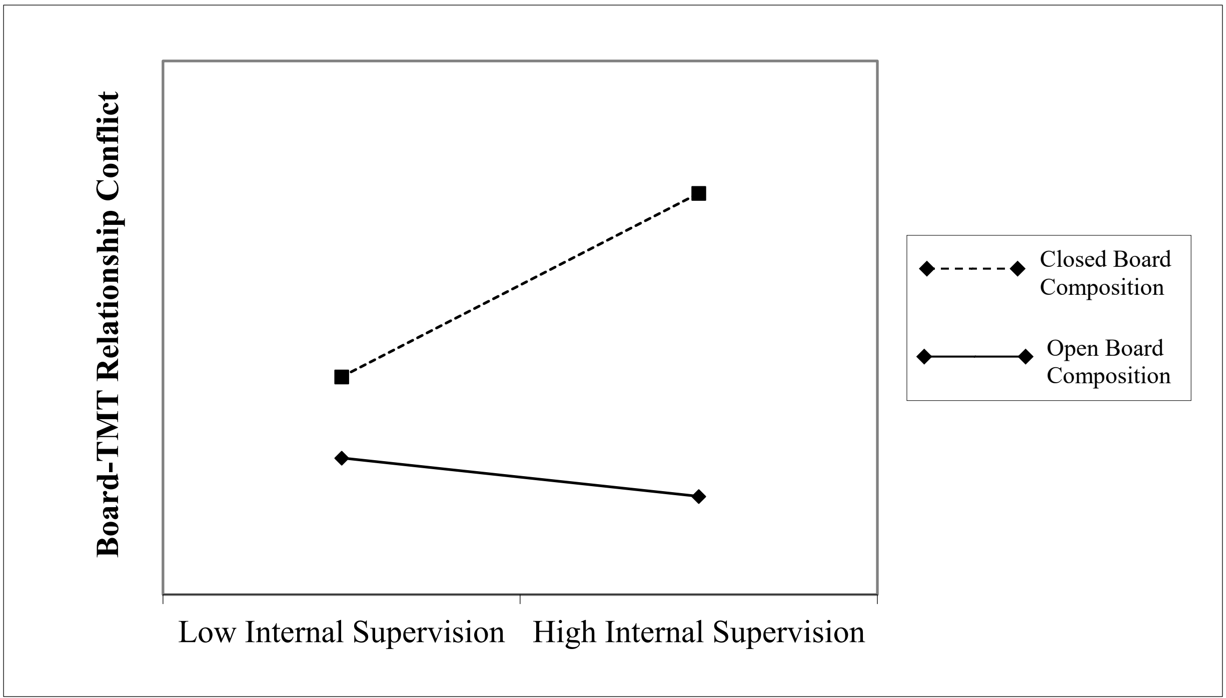
Variables	**Model 1**	**Model 2**
Internal Supervision (IS)	0.27*	0.17
Openness of Board Composition (OBC)	0.38**	0.45***
IS x OBC		0.26*
R2	0.15	0.20
Delta R2		0.05*

N = 56 organizations (boards and TMTs). *$p < .05$, **$p < .01$, ***$p < .001$

Standardized regression coefficients are reported.

FIGURE 4.2

The Moderating Effect of Openness of Board Composition on the Relationship Between Internal Supervision and Board-TMT Relationship Conflict



Hypothesis 2A predicted that Board-TMT relationship conflict was negatively related to TMT reflexivity, and Hypothesis 2B predicted that this relationship was moderated by the degree of external supervision, such that this relationship became less strong when external supervision increased. Table 4.4 (Model 2) shows no significant direct relationship between Board-TMT relationship conflict and TMT reflexivity (β = -.16, p = .15, R^2 = .04), hence we found no support for Hypothesis 2A. However consistent with Hypothesis 2B, we found a significant and positive interaction effect of external supervision and Board-TMT relationship conflict on TMT reflexivity (β = .27, p = .03, R^2= .10). Simple slope analyses (Aiken & West, 1991) further confirmed the prediction in Hypothesis 2B, that Board-TMT relationship conflict was significantly and negatively related to TMT reflexivity, when external supervision was lower *(-1 SD: β = -.59, SE = .27, p = .02).* This relationship became positive and non-significant when external supervision was higher *(+ 1 SD: β = .18, SE = .25, p = .23).* The graphical representation of the significant interaction effects as depicted in Figure 4.3, further illustrates a cross-over effect and confirms that the relationship between Board-TMT relationship conflict and TMT reflexivity became less strong when external supervision increased (Podsakoff, MacKenzie, Ahearne, & Bommer, 1995). Thus, we find support for Hypothesis 2B.

TABLE 4.4

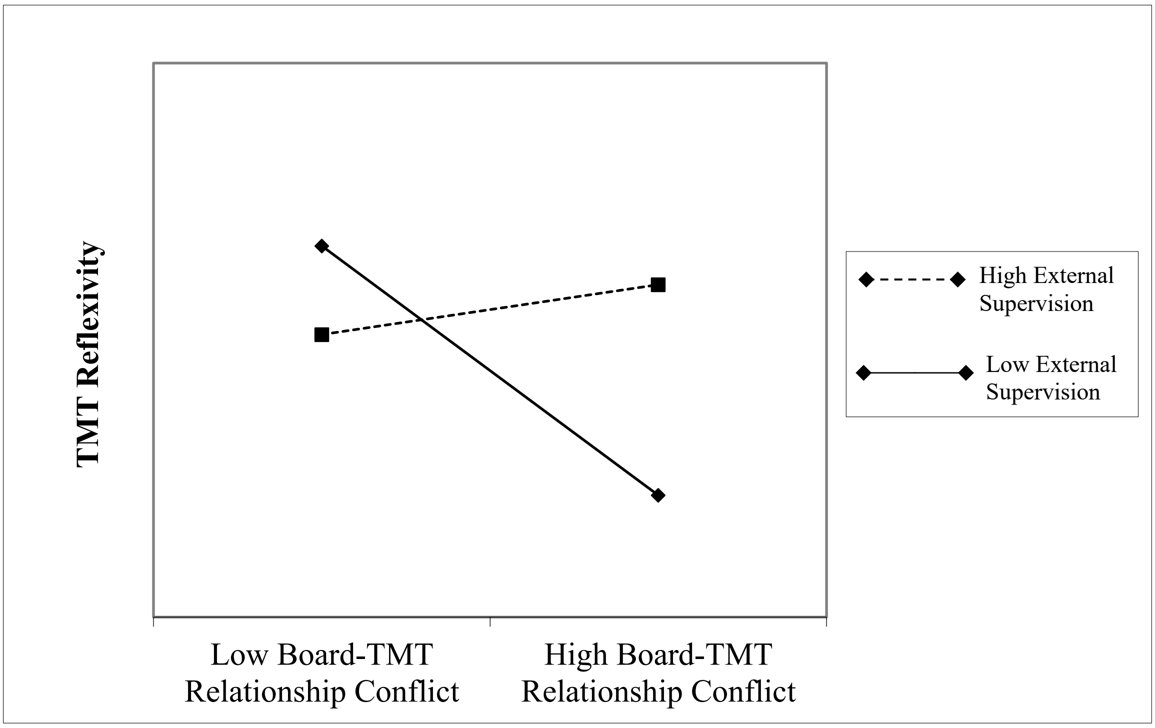
Regression Results for TMT Reflexivity

Variables	**Model 1**	**Model 2**	**Model 3**
Internal Supervision	0.14	0.17	0.16
Openness of Board Composition	0.03	0.09	0.06
Board-TMT Relationship conflict (BTRC)		-0.16	-0.18
External Supervision (ES)		0.02	0.11
BTRC x EM			0.27*
R2	0.02	0.04	0.10
Delta R2		0.02*	0.06*

N = 56 organizations (boards and TMTs). **p* < .05. Standardized regression coefficients are reported.

FIGURE 4.3

The Moderating Effect of External Supervision on the Relationship between Board-TMT Relationship Conflict and TMT Reflexivity



In order to test our full model as presented in Hypothesis 3, Table 4.5 presents the results of the moderated mediation macro using a bootstrap analysis (Preacher et al., 2007). Table 4.5 shows a significant conditional indirect effect of internal supervision on TMT reflexivity, through Board-TMT relationship conflict, when board composition was more closed indicated by higher minimum tenure (+1 *SD*), and at lower levels of external supervision (-1 *SD*; conditional indirect effect = -.16). The mediation effect of Board-TMT relationship conflict did not occur when board composition was more open and when external supervision was higher. Hence, we found support for Hypothesis 3.

TABLE 4.5

Results for Conditional Indirect Effects on TMT Reflexivity through Board-TMT Relationship Conflict

Conditional Indirect Effect at Openness of Board Composition and External Supervision = Mean ± 1 SD				
Openness of Board Composition	**External Supervision**	**Boot indirect effect**	**Bootstrap 95% confidence interval**	
			lower bound	upper bound
-1 SD (0.46)	-1 SD (3.09)	-0.01	-.0.20	0.18
-1 SD (0.46)	Mean (4.16)	-0.00	-0.10	0.06
-1 SD (0.46)	+1 SD (5.22)	0.00	-0.10	0.11
Mean (2.29)	-1 SD (3.09)	-0.08	-0.27	0.03
Mean (2.29)	Mean (4.16)	-0.03	-0.14	0.01
Mean (2.29)	+1 SD (5.22)	0.03	-0.03	0.20
+1 SD (4.11)	**-1 SD (3.09)**	**-0.16**	**-0.40**	**-0.01**
+1 SD (4.11)	Mean (4.16)	-0.05	-0.19	0.02
+1 SD (4.11)	+1 SD (5.22)	0.06	-0.07	0.31

N = 56 organizations (boards and TMTs). Bootstrap sample size is 1.000.

Bootstrap 95% bias corrected and accelerated confidence interval

DISCUSSION

Scholars agree that TMT reflexivity is essential for sound strategic decision making and can help prevent TMTs from falling prey to decision biases. To safeguard such reflexivity TMTs' decision making is supervised by internal and external supervisory bodies. However, there is theoretical debate and little empirical evidence with regard to how internal supervision and external supervision, independently and in conjunction, can influence such reflexivity, and scholars have therefore called for an integrative approach to study this question (e.g., Aguilera et al., 2015). To answer this call, this research combined corporate governance literature and social psychology literature to build and test a conceptual model that helps to understand *when* internal supervision is associated with relationship conflict between boards and TMTs, and how the openness of board composition can suppress this relationship. Moreover, our study further examines *how* external supervision, if this conflict does occur, can subsequently mitigate the negative relationship between conflict and TMT reflexivity.

Across a large field study among supervisory boards and TMTs of 56 insurance companies, in line with our predictions, we found that internal supervision by boards was positively related to Board-TMT relationship conflict, and that this relationship was moderated by the openness of board composition, such that this effect became less strong when board composition was more open (i.e., new members have entered the board recently). We did not find the proposed direct negative effect of Board-TMT relationship conflict on TMT reflexivity. As predicted, however, this relationship hinged on external supervision and Board-TMT relationship conflict had a less negative impact on TMT reflexivity when external supervision increased. Together, our findings demonstrated that internal supervision indirectly reduces TMT reflexivity, through Board-TMT relationship conflict, and this mediation was conditional on the openness of board composition and external supervision.

Theoretical Implications

The current study has several theoretical implications for the broad array of corporate governance and TMT reflexivity literature. First, our study is the first to test the independent effects of internal and external supervision on TMT reflexivity, and thereby provides insights into the fundamental debate between agency and stewardship theory. In this debate, agency theory, on the one hand, proposes that internal supervision and external supervision can help to align the inherent differences between the interests of boards and TMTs, and prevent TMTs from falling prey to decision biases that harm balanced TMT decision making (e.g., Jensen & Meckling, 1976; Ward et al., 2009). Stewardship theory, on the other hand, argues that frequent supervision, particularly internal supervision, may trigger interpersonal tensions between boards and TMTs, which, in turn, can undermine TMTs' motivation to make decisions in the interest of the organization (e.g., Davis et al., 1997; Donaldson & Davis, 1991). Our results show that internal supervision indeed indirectly, via Board-TMT relationship conflict, negatively affects TMT reflexivity, unless boards have a relatively open composition. External supervision can mitigate these negative effects, such that it can safeguard that TMT reflexivity maintains a sufficient level when Board-TMT relationship conflict does occur. Our results thus imply that each supervision body can have a positive influence on TMT reflexivity, but under different circumstances. This means that governance scholars need to take these distinct effects of internal and external supervision on TMT reflexivity into account to fully understand the effectiveness of supervision activities (Frink & Klimoski, 2004; Pennington & Schlenker, 1999).

Generally, our results for internal supervision seem to speak more in favor of stewardship theory. As we find that internal supervision can lead to relationship conflict between boards and TMTs (e.g., Davis et al., 1997; Kellermanns & Eddleston, 2004), especially when boards are relatively closed, and consequently can harm TMT reflexivity. Our findings add insights to stewardship theory, and show that Board-TMT relationship conflict is a key underlying mechanism explaining *why* internal supervision can reduce TMT reflexivity. This notion is touched upon by scholars relying on stewardship theory, but it is not yet fully explored in related research (Eddleston & Kellermanns, 2007). Our work thus illustrates the importance of relationship conflict for future research regarding the propositions of the stewardship perspective.

More specifically, our research helps solve the debate about the effectiveness of supervision and examines earlier neglected contingencies that explain *when* internal supervision is associated with Board-TMT relationship conflict and, subsequently, how external supervision is associated with TMT reflexivity. These contingencies have several implications. As for internal supervision, our results imply that it does not only matter *how* supervisory boards perform this internal supervision of TMTs (Sundaramurthy & Lewis, 2003), it also matters how boards are composed. An open board composition prevents the development of strict values and makes boards more open to differences in values with TMTs, which can prevent the rise of interpersonal tensions during the supervision process. This result also resonates well with recent corporate governance literature suggesting that board compositional characteristics play a role beyond board members' independence (Johnson, Schnatterly, & Hill, 2013). In this regard, some scholars argue that board member rotation may limit the board's ability to acquire relevant firm knowledge (Fischer & Pollock, 2004; Kor & Sundaramurthy, 2009; Vafeas, 2003). However, our work offers additional evidence that putting a maximum on board members' tenure could increase the effectiveness of internal supervision, as the influx of new board members can prevent the development of strained relationships with TMT members (Golden & Zajac, 2001; Vafeas, 2003).

For external supervision, our research implies that once conflict is present, independent external supervisory bodies can intervene in such a way that this conflict becomes less harmful for TMT reflexivity. Given this influence of external supervisory bodies, governance scholars could broaden their scope to include the role of independent supervisory institutions more specifically in their research, besides other external governance mechanisms (Ward et al., 2009). Moreover, this inclusion helps to build a more integrative approach that systematically examines the interdependencies between internal and external supervision (Aguilera et al., 2015). For example, based on our findings, it seems that the two forms of supervision complement each other in influencing TMTs, and thus can compensate for each other's weaknesses (e.g., Tosi, Katz, & Gomez-Mejia, 1997; Walsh & Seward, 1990), rather than act as substitutes that are mutually exclusive (e.g., Dalton, Hitt, Certo & Dalton, 2007). Thus, our research suggests that internal and external supervision can strengthen each other in their *joint* influence on TMT decision making, and that external supervision does not act *independently* from internal supervision (see also Chapter 2 of this dissertation), and we also find this in relation to an important social contextual factor; Board-TMT relationship conflict (Misangyi & Acharya, 2014; Ward et al., 2009).

Strengths, Limitations, and Future Research

The current research has several strengths. First, our research was based on complete psychological questionnaires and matching individual and team-level data from 56 TMTs and their supervisory boards that operate in a hierarchical two-tier system within the same organization. This is valuable data from real-life and high-level organizational groups that are usually hard to access for scientific research. This sample enabled us to gain insight into the 'black box' of the actual behavioral group processes between boards and TMTs (Leblanc & Schwartz, 2007). Second, we used multiple sources to assess our psychological measures and this reduced common source bias (Podsakoff, Mackenzie, Lee, & Podsakoff, 2003); our independent variables (i.e., internal and external supervision, and Board-TMT relationship conflict) were rated by board members, our key dependent variable (i.e., TMT reflexivity) was rated by TMT members, and one moderator (i.e., openness of board composition) was based on archival data.

However, our research also has some limitations. As our study was cross-sectional in nature, it is difficult to make inferences about the direction of causality between our study variables. Second, we expect that our results are applicable for all board structures because the monitoring tasks studied in this chapter are similar for members of the supervisory board in a two-tier board and non-executive directors in a one-tier board. However, some caution should be applied when generalizing our findings, since we have studied insurance companies with a two-tier board, that are specific to the Netherlands and other Rhineland countries (Bezemer et al., 2007). Moreover, there might be some limitation to our measure of Board-TMT relationship conflict as we only included the ratings provided by supervisory board members of the conflict in order to prevent common source issues. We consider this approach warranted, because we did measure the conflict experiences of both parties, and find sufficient agreement between boards and TMTs on these experiences (Klein, Palmer, & Conn, 2000; Richter, Scully, & West, 2005). The use of this measure may, however, explain why we did not find the hypothesized direct relationship between Board-TMT relationship conflict and TMT reflexivity. Finally, we realize that by measuring internal and external supervision based on their monitoring activities we were not able to capture the complete array of tasks and characteristics of internal and external supervisory bodies. This measurement approach fits the purpose and scope of the present study, as our measures are validated and frequently used in similar research to study supervision through its core monitoring activities (McDonald & Westphal, 2010). Nonetheless, future research can use more detailed measures to explore the fine-grained effects of different characteristics of internal and external supervisory bodies.

To address these limitations, future research could consider to further study the combinations of used measures and include other board characteristics, to create a more complete insight in the studied relationships. For instance, future research could study the effects of other board compositional characteristics that are also found to impact intergroup conflict, such as educational background or group values (Hambrick et al., 2001; Jehn et al., 1997; Pelled & Adler, 1994).

Moreover, there is a large avenue for future research to investigate what specific skills and competences internal and external supervisory bodies could develop and use to effectively supervise the quality of Board-TMT relationships and influence TMT reflexivity. With regard to internal supervision, it would be worthwhile to study what supervisory boards can do to keep Board-TMT relationships healthy. One possibility offered by SIT scholars is the development of a superordinate identity, in which two different groups adhere to the same organizational identity and goals, and this is considered an effective way to prevent intergroup conflict (Gaertner, Rust, Dovidio, Bachman, & Anastasio, 1994). Future research could then explicitly study the degree to which boards and TMTs consider themselves as in- and outgroup, due to internal supervision, and tests whether having a superordinate organizational identity can limit the degree of Board-TMT relationship conflict as a result.

With regard to external supervision, one can make inferences based on conflict research about what an effective intervention for external supervisory bodies can look like. For example, external supervisory authorities should have the skills to effectively start a dialogue when Board-TMT conflict arises (e.g., Karambayya et al., 1992), as well as the expertise to design interventions that stimulate TMT reflexivity through performance feedback (e.g. Gurtner et al., 2007). Currently, little is known about the unique skills external supervisory bodies use in their interventions and their effectiveness. Therefore, this would be a fruitful question for future research.

Practical Implications

Our findings have practical implications for organizations and supervisory authorities that offer policy makers concrete tools to improve internal and external supervision, in order to realize healthy boardroom dynamics and enhance TMT reflexivity. First, with regard to the composition of supervisory boards, our results imply that a more dynamic and diverse succession plan for supervisory board members should be used, and this might require amending governance rules regarding supervisory board tenure, which ensures the timely and frequent appointment of new members and rotation within internal supervisory boards (Vafeas, 2003). Moreover, these findings imply that effective internal supervision also entails managing the relationship with TMTs, which requires the specific attention of supervisory boards and skills to effectively deal with conflict.

Second, external supervisory authorities should actively monitor whether there are first signs of relational tensions between boards and TMTs. Accordingly, increased external supervision activities can include a risk-assessment of TMT relationships with their boards and determine its impact on board effectiveness. When Board-TMT relationship conflict is already present external supervisory bodies should actively intervene to prevent that TMT reflexivity will be reduced, act as mediators (Karambayya et al., 1992), and employ tailored interventions to increase TMT reflexivity that includes performance feedback (Gurtner et al., 2007; Peterson & Behfar, 2003).

Conclusion

In short, our study shows *when* internal supervision is associated with relationship conflict between boards and TMTs, and *how* external supervision can subsequently mitigate the negative effects of such conflict on TMT reflexivity. Our research shows that relational Board-TMT conflict due to frequent internal supervision, can be suppressed by adopting an open board composition, with new members entering frequently. Once this conflict is present we find that external supervisory bodies can act to make this conflict become less harmful for TMT reflexivity. Our study provides important insights for organizations, supervising authorities, and policy makers, to ensure that the combination of internal and external supervision safeguards TMT reflexivity, and reduces the potential for Board-TMT relationship conflict.

APPENDIX 4A

Survey Measures, References and Rating Sources

Survey measures conceptual model part 1	Reference	Sources
Internal TMT supervision 1. To what extent does the supervisory board monitor the strategic decision making of the top management team? 2. [In the past twelve months:] how often did the supervisory board asked for revisions of a proposed risk mitigating measures by the top management team? 3. To what extent does the supervisory board request information to evaluate the risk assessment of the top management team?	McDonald and Westphal (2010)	Directors
Board-TMT relationship conflict 1. How much relationship tension is there between the top management team and the supervisory board? 2. How often do the top management team and the supervisory board get angry during meetings? 3. How much emotional conflict is there between the top management team and the supervisory board?	Jehn and Mannix (2001)	Directors
Survey measures conceptual model part 2		
External TMT supervision 1. To what extent does DNB monitor the strategic decision making of the top management team? 2. [In the past twelve months:] how often did DNB insist on revisions of a proposed risk mitigating measures by the top management team?	McDonald and Westphal (2010)	Directors

3. To what extent does DNB request information to evaluate the risk assessment of the top management team?		
TMT Reflexivity 1. We regularly discuss whether the top management team is working together effectively. 2. We regularly have critical discussions how the top management team operates. 3. The objectives of the top management team are regularly critically discussed. 4. In this top management team we adapt our objectives in light of changing circumstances. 5. The methods of the top management team are rarely changed. (R) 6. We discuss regularly the extent to which information is well shared within the top management team. 7. The way decisions are made in this team is rarely altered.(R) 8. We regularly reflect on the way in which decisions are made.	Schippers, Den Hartog and Koopman (2007)	TMT members

APPENDIX 4B

Means, Standard Deviations, Correlations with Control Variables

	Mean	S.D.	1	2	3	4	5	6	7	8	9	10	11	12
1. TMT size	2.46	1.06												
2. Number of females in TMT	0.07	0.16	.15											
3. TMT age	52.35	5.21	.21	- .08										
4. Openness of TMT composition	4.19	3.62	-.25	-.19	.38**									
5. Board size	3.98	1.51	.13	-.12	-.04	.01								
6. Board age	57.78	5.19	-.16	.11	-.09	.07	-.00							
7. Openness of board composition	2.33	1.86	.24	.07	.43**	.34*	-.26	.06						
8. Number of females in board	0.13	0.18	-.04	-.12	-.18	-.11	.34*	-.14	-.27*					
9. TMT reflexivity	4.92	0.71	-.04	-.03	.15	.10	-.16	-.05	-.00	.22				
10. Board-TMT relationship conflict	1.76	0.66	.14	-.05	.06	-.02	-.01	.15	.27	-.17	-.13			
11. Internal supervision	5.23	0.78	.06	-.03	-.04	-.32*	.27	-.08	-.34*	.22	.17	.15		
12. External supervision	4.17	1.10	.16	.02	.07	-.01	.42**	.18	-.12	.23	.06	.22	.35*	

$N = 52$ *$p < .05$, **$p < .01$.

APPENDIX 4C

Extra Statistical Analyses

Extra Analysis Including Board-TMT Task Conflict in the Conceptual Model

To test for an alternative model that assumes that internal supervision is also associated with task conflicts between supervisory board and TMT, and can affect TMT reflexivity (De Wit, Greer, & Jehn, 2012) we re-ran the analyses for Hypothesis 1A-B, 2A-B and 3 with Board-TMT task conflict as mediator. Board-TMT task conflict was measured with three adapted items of Jehn and Mannix (2001,. e.g., “How much conflict of ideas is there between the top management team and the supervisory board?”, “How frequently do the top management team and the supervisory board have work related disagreements?”, “How often do the top management team and the supervisory board have content related conflicting opinions?”). These items were rated on a 7-point scale (1 = never, 7 = very often), and together formed a reliable scale (α = .87). The $r_{wg(j)}$ and ICC_1 statistics warranted that the data could be aggregated to the team-level (ICC_1 = .28, p <.001; compared to a uniform distribution, median $r_{wg(j)}$ = .92, mean = .88; compared to a highly skewed distribution, median $r_{wg(j)}$ = .77, mean = .60).

Post hoc analysis showed that Board-TMT task conflict was not a significant mediator in this alternative model. We found no significant interactive effect for openness of board composition (β = .05, p = .73), and there was also no significant interactive effect for external supervision (β = .07, p = .67). The moderated mediation macro of Preacher and colleagues (2007) with Board-TMT task conflict as mediator showed no significant interactions and no significant mediation for any level of the moderators, because the bootstrap analysis yielded a confidence interval that contained zero (N = 56; 1000 re-samples).

Extra Analysis including Control Variable Openness of TMT Composition

To further test the robustness of our effects, we also re-ran all analyses reported in this chapter with the openness of TMT composition as extra control variable. Including this variable the results remain consistent with the results found for Hypotheses 1A-B, 2A-B and 3, and did not change our results significantly. We found a significant and positive direct relationship between internal supervision and Board-TMT relationship conflict (β = .26, p = .03, R^2 = .15). We also found significant interactive effects of openness of board composition on the relationship between internal supervision and Board-TMT relationship conflict, (β = .26, p = .04, R^2 = .20). Again, we found no significant relationship between Board-TMT relationship conflict and TMT (β = -.15, p = .17, R^2 = .05). We also found a significant interactive effect of external supervision on the relationship between Board-TMT relationship conflict and TMT reflexivity (β = .30, p = .02, R^2 = .12). The Hayes Bootstrapping macro shows there was a significant conditional indirect effect of internal supervision on TMT reflexivity, through Board-TMT relationship conflict when board composition was more closed, indicated by higher minimum tenure (i.e., +1 *SD*) and lower levels of external supervision (i.e., -1 *SD*; conditional indirect effect = -.16).

CHAPTER 5

GENERAL DISCUSSION

Numerous events, such as the diesel-emission scandal and the financial crisis highlighted in Chapter 1, have illustrated the growing importance of effective internal and external supervision for society. Societies trust that internal and external supervisory bodies will effectively monitor whether decisions of organizations are sound and will protect the long-term interests of all relevant organizational stakeholders, including the general public (Aguilera, Desender, Bednar, & Lee, 2015). Although corporate governance literature has provided valuable insights into the isolated effects of these two supervisory bodies on the performance of organizations as a whole (e.g. Rechner & Dalton, 1991; Tosi, Brownlee, Silva, & Katz, 2003), there is still limited theoretical and empirical knowledge about their independent and joint effects on the actual decisions made by Top Management Teams (TMTs), middle managers and employees (Aguilera et al., 2015).

Based on an integrative and interdisciplinary literature review, my dissertation contributes to corporate governance literature by addressing the following three interrelated research gaps: 1) the independent effects of internal and external supervision in comparison to each other, as well as their relationship in terms of their joint impact on decision making in organizations (Aguilera et al., 2015); 2) the effectiveness of internal supervision by the compliance function in conjunction with organizational values, in relation to employee decisions (e.g. Daily, Dalton, & Cannella, 2003; Davidson, Dey, & Smith, 2015); and 3) the link between structural governance factors, behavioral group processes and TMT decision making (e.g. Filatotchev, 2008). To address these gaps, my main research questions are:

1. How will internal and external supervision, independently and in relation to each other, impact decision making of TMTs, middle managers and employees?
2. What psychological mechanisms explain these effects? and,

3. How do contextual factors impact these relationships?

In this general discussion, I will first discuss the main findings presented in each of the empirical chapters (2-4), before I will reflect on the findings in light of the posed research questions and the contributions of my research to corporate governance literature. I will further discuss the strengths and limitations of the used empirical approach, and I will propose avenues for future research. Finally, I will reflect on the practical implications of my research for organizations, supervisory bodies, and policymakers to enhance the effectiveness of internal and external supervision and their relationship in order to safeguard sound organizational decision making.

SUMMARY OF MAIN FINDINGS PER CHAPTER

The main goal of Chapter 2 was to examine the independent and joint impact of internal and external supervision, as well as their respective perceived power, in relation to decision making of middle managers and employees. In this chapter, I proposed that internal supervisory bodies would have a stronger impact on the decisions of these organization members than external supervisory bodies (Brass, Butterfield, & Skaggs, 1998; Emerson, 1962), because of their higher perceived power levels (Hillman & Dalziel, 2003). Specifically, I expected that internal supervisory bodies would be perceived to hold more power derived from their formal position as well as their personal characteristics, due to their relationship with the organization in terms of its resources and its members (e.g., Brass et al., 1998). Finally, I explored whether there is an additional value for the combined presence of both supervisory bodies.

I tested these predictions by means of a multi-method research approach, combining a field survey among 418 middle managers and employees, and an experimental scenario among 62 financial middle managers. The results together revealed that the presence of internal supervisory bodies was indeed more strongly related to decisions of middle managers and employees than the presence of external supervisory bodies. This stronger relationship for internal supervisory bodies was explained by their higher perceived power compared to external supervisory bodies, and in particular their power based on formal position, and not their power based on personal characteristics. The findings further suggested that the presence of *both* supervisory bodies did not automatically provide additional advantages, as organization members primarily responded to the presence of internal supervisory bodies.

Chapter 3 examined how internal supervision by the compliance function and its program of activities (i.e., compliance programs), together with the presence of organizational values, impact employees' decisions. In this chapter, I proposed that the presence of compliance programs and organizational values are both related to sound decision making by employees (e.g., Kaptein, 2015; Kish-Gephart, Harrison, & Treviño, 2010), and I explored whether their joint presence had a stronger effect (Weaver & Treviño, 1999). In this respect, I expected that compliance programs and organizational values will both achieve the desired behavior that fosters sound decision making (e.g., Weaver & Treviño, 1999), because they signal different sources of perceived power of compliance officers over employees' decision-making behavior (French & Raven, 2001). Specifically, I predicted that compliance programs signal compliance officers' power based on their position to monitor and sanction rule violations (e.g., Tyler & Blader, 2005). Additionally, I proposed that organizational values will signal power of compliance officers based on their personal characteristics, because they provide organization members with informal guidance to understand the common social norms (e.g., Van Knippenberg, 2011).

I tested these predictions in a field survey among 78 professional compliance officers. The results show that either compliance programs or organizational values are related to employees' decision making, but the combined presence of both organizational characteristics did not have a stronger impact. In addition, I find that the relationship between organizational values and employee decision making was explained by compliance officers' perceived power based on their personal characteristics. However, the relationship between formal compliance programs and employees' decisions was not explained by compliance officers' perceived power based on their formal position.

Chapter 4 was designed to examine the link between internal supervision and supervisory board composition, as structural governance factor, with intergroup conflict, as behavioral group process, and TMT decision making, in relation to the role of external supervision. Specifically, I predicted that internal supervision can be related to conflict between internal supervisory boards and their TMTs (Board-TMT conflict), but that the likelihood of such conflict would be reduced when the structural composition of internal supervisory boards included new members who have recently entered the board (e.g., Hogg, 1992). I also argued that when such conflict would arise it could harm TMT decision making, and under such circumstances, external supervision can intervene by increasing their monitoring activity and thereby prevent the negative consequences of such conflict (e.g., Jehn & Bendersky, 2003).

I examined these predictions with a multi-level field survey among 111 TMT members and 152 internal supervisory board members of 56 insurance companies. The results indicated that frequent internal supervision is associated with Board-TMT conflict, but this relationship was less strong when TMTs were supervised by boards with new members who entered recently. The result showed that when there was Board-TMT conflict, its negative relationship with TMT decision making was less strong when external supervision increased.

THEORETICAL CONTRIBUTIONS AND IMPLICATIONS

This dissertation integrates different streams of literature in the disciplines of corporate governance, organizational behavior and social psychology. With this integrative approach my research provides some important contributions to corporate governance literature, and specifically to the debate between agency theory and stewardship theory highlighted in Chapter 1. Together my results reveal three common patterns that advance our understanding on, 1) the independent impact and relationship of internal and external supervision in relation to decision making, 2) the psychological mechanisms that explain these effects, and, 3) the impact of contextual factors on these relations. In the following sections I will highlight these theoretical contributions as well as the implications of the results.

The Independent Impact and Relationship of Internal and External Supervision

This dissertation provides a more comprehensive understanding of the multiple dimensions that comprise the effectiveness of both internal and external supervision, independently *and* together, in relation to the decisions made by TMTs, middle managers and employees (Aguilera et al., 2015).

First, regarding *internal supervision*, the findings of Chapters 2 and 3 together show that internal supervisory bodies' independent presence and their program of activities are directly associated with decisions of middle managers and employees. Moreover, the results of Chapter 4 show that the frequency of internal supervision is indirectly associated with TMT decision making via Board-TMT conflict. These findings have implications for the fundamental debate in corporate governance literature between agency theory (Jensen & Meckling, 1976) and stewardship theory (Donaldson, 1990; Donaldson & Davis, 1991), especially with respect to the unique impact of internal supervision on decision making. On the one hand, the results of Chapters 2 and 3 support assumptions of classical agency theory (e.g., Jensen & Meckling, 1976), by indicating that internal supervisory bodies can reduce self-serving biases in decision making of organization members. Internal supervision can thus have a positive effect, in the sense that individuals will consider more perspectives and make more sound decisions as a result (Lerner & Tetlock, 1999). On the other hand, in line with stewardship theory (e.g., Donaldson & Davis, 1991), Chapter 4 shows that frequent internal supervision can also lead to tensions in the relationship between supervisory boards and TMTs, and thereby hamper TMTs' decision-making abilities. In other words, internal supervision can have a negative impact by inducing a threat for TMT decision making (Frink & Klimoski, 1998; Hall, Frink, & Buckley, 2017). Hence, my findings show that internal supervision can actually trigger both positive and negative effects as predicted by agency theory ánd stewardship theory, but that these effects occur under different circumstances.

Second, Chapter 2 shows that the independent presence of *external supervision* has a limited direct impact on the decisions made by middle managers and employees. This result is in line with the argument of agency scholars that external supervisory bodies primarily interact with executives, and thus have little contact with other organization members who therefore are less aware of the presence of these bodies (Sinclair, 1995). Following this reasoning, external supervisory bodies are more likely to have a larger influence on executive decisions than on those made by middle managers and employees (Westphal, 1998).

Finally, with regard to the *relationship* between internal and external supervision, Chapter 2 shows that a) internal supervisory bodies have a stronger impact on decision making than external supervisory bodies, and that, b) there is no automatic additional advantage of the combined presence of both bodies. In this respect, the results in Chapter 4 do suggest, however, that in the case that internal supervision is associated with Board-TMT conflict, external supervision *can* mitigate the negative consequences of such conflict for

TMT decision making. These findings provide novel insights to corporate governance literature about the relative influence of internal and external supervision. On the one hand, by studying the combination of both forms of supervision and thus going beyond the previously found isolated effects (e.g., Tosi et al., 2003). On the other hand, by showing that in general the decisions of organization members are influenced more by internal supervisory bodies than by external supervisory bodies (e.g., Ellemers et al., 1998; Platow & van Knippenberg, 2001). Moreover, my findings contribute to the current debate in corporate governance literature about how internal and external supervision relate to each other, and my results tentatively point towards a complementary relationship (e.g., Walsh & Seward, 1990). In the sense that, external supervision can compensate for the negative consequences of ineffective internal supervision (Milgrom & Roberts, 1992), for example when this results in conflict between internal supervisory boards and TMTs. External supervisory bodies can do so by *actively* monitoring and intervening in the situation (Garcia, 2010), but they need to be careful not to overstep or substitute internal supervision when it is operating effectively (Frey & Jegen, 2001).

What Psychological Mechanisms Explain the Impact and Relationship of Internal and External Supervision

My dissertation also highlights the role of perceived power and intergroup conflict as psychological mechanisms, which explain the effectiveness of internal and external supervision and the combination of both in relation to decision making (Westphal & Zajac, 2013).

First, with regard to power, in Chapters 2 and 3, I demonstrated that high levels of perceived power of *internal supervision* explain its impact on decisions of middle managers and employees (e.g., Keltner, Gruenfeld, & Anderson, 2003). On the one hand, I found that internal supervisory bodies were perceived to have power, stemming from their formal position to administer rewards and sanctions (e.g., Tenbrunsel & Messick, 1999). On the other hand, in particular for the compliance function, my results indicate that their perceived power was primarily derived from personal characteristics to build trust and relationships with organization members (e.g., Ellemers, De Gilder, & Haslam, 2004). Thus, internal supervisory bodies can select or combine different sources of powers (French & Raven, 2001), but the availability of these power sources may differ per internal supervisory body.

In addition, the findings of Chapter 2 show that *external supervision* has some perceived power in the eyes of middle managers and employees, but neither their perceived power levels nor its specific source were directly related to the decisions of these organization members. These results challenge traditional views in corporate governance literature that external supervisory bodies can effectively influence organizational decision making due to their intervention powers (e.g., Barth, Lin, Ma, Seade, & Song, 2013; Laeven & Levine, 2009). My findings indicate, however, that external supervisory bodies' perceived power may have less impact on decisions of middle managers and employees, as such authorities can only exercise their power over these organization members indirectly, for example by fining the organization and its operations (Adams & Ferreira, 2012).

With regard to the *combination* of internal and external supervision, the results of Chapter 2 show that they were also perceived to be relatively powerful when they were both present (in terms of position as well as personal power), but this perception did not result in a combined stronger impact on organization members' decision making. When comparing the perceived power of the two bodies, my findings show that internal supervisory bodies are perceived to have higher power than external supervisory bodies, and therefore these former bodies have a stronger impact on organization members' decisions. This higher perceived power of internal supervisory bodies is no surprise from a social psychological perspective

(Hillman & Dalziel, 2003; Rus, Van Knippenberg, & Wisse, 2011). Given their position within organizations, internal supervisory bodies have more access to organizational resources, and can interact more frequently with organization members than a more distant external supervisory bodies can (e.g., Brass et al., 1998).

Second, with respect to conflict, the results of Chapter 4 demonstrated that Board-TMT conflict is a key mechanism underlying the impact and relationship of internal supervision and external supervision in relation to TMT decision making. These findings provide preliminary empirical evidence for the theoretical notion that how supervisory boards perform their internal supervision impacts their relationship with TMTs, and consequently TMT decision making (Eddleston & Kellermanns, 2007). Subsequently, my results suggest that external supervision can prevent potential negative consequences for decision making when a conflict arises between internal supervisory boards and TMTs. In this respect, my dissertation adds insights from conflict research to corporate governance literature (e.g., De Dreu, 2010). One the one hand, my research shows the importance of intergroup conflict for the effectiveness of internal supervision (Hambrick, Werder, & Zajac, 2008; Hillman, Nicholson, & Shropshire, 2008). On the other hand, my findings suggest that external supervision, in relation to internal supervision, can act effectively as a third party in Board-TMT conflicts (Halevy, Halali, & Zlatev, 2018).

Contextual Factors and the Impact and Relationship of Internal and External Supervision

My dissertation also generated valuable insights into the moderating role of certain contextual factors, which determine the independent impact and interplay of internal and external supervision in relation to decision making (e.g., Filatotchev, 2008; Misangyi & Acharya, 2014).

First, Chapter 4 shows that the team composition of internal supervisory boards is an important structural governance factor that determines the independent impact of *internal supervision* on TMT decisions. When this board composition also includes new members that have entered the board recently, the frequency of internal supervision is less related to Board-TMT conflict. Prior work already showed the relevance of other structural board characteristics, such as independence, size, and diversity for effective internal supervision (Boivie, Bednar, Aguilera, & Andrus, 2016; Johnson, Schnatterly, & Hill, 2013). My research contributes knowledge to this work with regard to the positive effects of board membership changes on the relationship of internal supervisory boards with TMTs (for a review, see Rink, Kane, Ellemers, & Van der Vegt, 2013).

Second, another notable finding regarding the *relationship* between internal and external supervision, is that when Board-TMT conflict did arise (due to little membership changes in the internal supervisory board) increased external supervision could effectively mitigate the potential negative consequences of such conflict for TMT decision making. Thus, while prior research primarily identified firm-level contextual factors that may influence the relationship between internal and external supervision (Misangyi & Acharya, 2014; Ward, Brown & Rodriguez, 2009), I show that also a structural board compositional feature can affect the nature of this relationship (Desender, Aguilera, Crespi, & García-Cestona, 2013).

STRENGTHS, LIMITATIONS, AND FUTURE RESEARCH DIRECTIONS

This dissertation has several strengths. First, I deployed a multi-method, multi-level research approach, by combining field and experimental studies (Chapter 2-4), and by studying decision making at the individual- and team-level (Chapter 2 and 3). Second, I also collected data from multiple sources ranging from TMT executives, internal supervisory board members, compliance officers, middle managers, and employees. Especially these samples from the top executive level are generally difficult to access for researchers (LeBlanc & Schwartz, 2007). Finally, I examined internal and external supervision in general terms in Chapter 2 (i.e., accountability to an internal and external supervisory body), and in specific terms in Chapter 3 (i.e., the compliance function and its program of activities) and Chapter 4 (i.e., the internal supervisory board, and an external supervisory body for the financial sector, De Nederlandsche Bank). These last two strengths enhanced the external validity of my research and the generalizability of the results to a wide range of organizations (Campbell & Stanley, 1966).

Regardless of these strengths, this dissertation also has some methodological limitations that are relevant to consider when interpreting the results and also for future research. First of all, the limitations of cross-sectional research apply to most studies presented in the empirical Chapters 2-4 (except for Study 2.2), limiting the possibility to make inferences about causal relationships. To establish causality of the studied relationships longitudinal research is needed. Furthermore, most studies were conducted within the financial sector in the Netherlands that is regulated by Dutch Financial law (e.g., Financial Supervision Act), and this sector is confronted with high levels of internal and external supervision. This specific institutional context may have impacted the attitude and responses of participants with respect to supervision. Moreover, as stipulated by the Dutch Financial Supervision Act (Wft) most financial organizations have a two-tier board structure in which the internal supervisory board is separated from the TMT, as is also common in other Rhineland countries (Jungmann, 2006; Mallin, 2007). Hence, while I expect that my findings are applicable to a wide range of organizations, some caution is advised when generalizing these findings to other institutional contexts and/or countries (Bezemer, Maassen, Van den Bosch, & Volberda, 2007).

Furthermore, this dissertation was limited in the opportunities to gather the type of data needed to more objectively study the direct link between decision making and financial performance. In my research I focused on decision making as the most reliable proxy for organizational performance (Desender et al., 2013; Deutsch, 2005; Kosnik, 1987), and future research is still needed to more conclusively establish the direct link between decisions and organizational performance by collecting objective financial data (e.g., Eisenhardt, 1989; Fredrickson & Mitchell, 1984). To further establish this link, such financial data could be combined with valuable outcomes on decision making that can be collected with field surveys and experimental scenarios as used in this dissertation, and enriched with other research techniques designed to observe actual decision-making behavior, such as participative observations of TMT meetings (Jick, 1979).

Beyond addressing the limitations mentioned above, my research provides interesting directions for future research. First, I studied the independent and joint presence of different internal and external supervisory bodies, and future research could enrich this knowledge by studying the impact of the *multitude* of supervisory bodies. In reality, multiple internal supervisory bodies are present within organizations (i.e., the internal supervisory board, as well as the compliance, risk management, and internal audit functions), as well as multiple external supervisory bodies with different mandates that are simultaneously supervising the *same* organizations. It is very likely that organization members supervised by multiple supervisory bodies experience competing or complementary information requests as well as behavioral norms that may undermine supervisory effectiveness (Tetlock, 1992). Research confirms this prediction by showing that such a situation may confuse organization members to which supervisory body they have to justify what (Tetlock & Boettger, 1994), and makes people avoid accountability over their decisions altogether (Green, Visser, & Tetlock, 2000).

Hence, future research could study how the presence of multiple internal and external supervisory bodies may impact their independent and joint impact on decision making.

Second, given the attention for unethical behavior after several misconduct scandals, future research could investigate more explicitly how supervision can prevent such behavior and its consequences. In particular, the results of Chapter 3 provide preliminary insight into the influence of internal supervision by the compliance function in relation to such employee behavior, together with organizational values. Researchers could expand this work by studying the role of the ethical climate in teams, as recent insights show that behavior of team members and their manager have a more direct influence on the ethical decisions of individuals than collective organizational values do (Ellemers & Van der Toorn, 2015). It is argued that such role modelling behavior informs teammates more specifically on what is accepted ethical decision-making behavior (Moore & Gino, 2013). Therefore, this team climate, which signals whether unethical behavior is normal within the team (Duffy, Scott, Shaw, Tepper, & Aquino, 2012; Gino, Ayal, & Ariely, 2009), can determine if certain teams within the same organization are more or less prone to display unethical behavior (Goldstein, Martin, & Cialdini, 2008). Moreover, there is some research that shows the positive effect of outside observers, such as supervisors, on ethical behavior, even when unethical behavior is common in the group (Gino, Gu, & Zhong, 2009). With this in mind, future research could examine the relatively unexplored link between supervision and a team's ethical climate (Scholten, 2018), and how this relates to ethical decision making.

Third, future research could explore how the availability of resources for internal and external supervision impacts supervisory effectiveness. Practical case studies and reports from international advisory bodies suggest that an insufficient amount of organizational resources for internal and external supervision poses a large threat for adequately performing their daily work (Group of Thirty, 2015; Kirkpatrick, 2009; Van Rooij & Fine, 2018). These claims seem to imply that higher quantities of organizational resources would automatically make internal and external supervision more effective. Whilst my research shows that it may actually be the quality of organizational resources that these supervisory bodies control, in terms of their economic and social value, which provides them with social power over organization members' decisions (French & Raven, 2001; Keltner et al., 2003). The foregoing begs the question of whether having access to the right type of resources and thus social power can make supervisory bodies effective with less resources, or whether there is a threshold amount of resources that is always necessary to perform supervision. Future research could then examine how the quality and quantity of resources are both related to supervisory effectiveness.

Fourth, my research in Chapter 4 on Board-TMT conflict suggests that the quality of the relationship between supervisory bodies and the groups they supervise is an important mechanism underlying supervisory effectiveness. Future research could extend these findings, by studying the role of trust in the supervisory relationship for both internal and external supervisory bodies (Six, 2013). Trust scholars argue that members of supervised organizations perceive trust when they share fundamental values with the supervisory body, and if they are treated fairly and with respect when these bodies enact procedures (Tyler & Huo, 2002). If so, members will repay this felt trust by increasing cooperation with the supervisory body (Ring & Van de Ven, 1994). Research indeed shows that such trust leads to achieving supervisory outcomes, such as enhanced voluntary compliance of organizations with the rules (e.g., Braithwaite & Makkai, 1994; Murphy, 2004b), and more disapproval of rule-breaking by organization members (Mulder, Verboon, & De Cremer, 2009). Despite this evidence, there is still debate among scholars how trust and supervision exactly relate to each other (Six, 2010), and future research is necessary to study how the degree of trust in the supervisory relationship explains internal and external supervisory bodies' effectiveness.

PRACTICAL IMPLICATIONS

Effective internal and external supervision are both important to safeguard sound decision making in organizations in order to protect the interests of organizational stakeholders, including the general public (Aguilera et al., 2015). Based on the presented findings, I will discuss several practical recommendations that can give guidance to enhance the independent effectiveness of, and optimize the relationship between, internal and external supervision in relation to decision making in organizations.

A first practical recommendation that can be derived from my research, is that *internal supervision* performed by different supervisory bodies, ranging from internal supervisory boards to the compliance function, has a large influence and perceived power over decision making of TMTs, middle managers and employees in organizations. Important factors that contribute to internal supervisory effectiveness are, amongst others, 1) the presence and activities of internal supervisory bodies, 2), internal supervisory bodies' perceived power and its sources, 3) the composition of the internal supervisory board, and, last but not least, 4) the relationship between these boards and TMTs. For each of these factors, I will provide some examples for possible courses of action that organizations and internal supervisory bodies can pursue to enhance the effectiveness of internal supervision.

A first step that organizations can take, is to assess organization members' awareness of the presence and activities of different internal supervisory bodies within the organization. If these bodies are perceived to be (nearly) absent, organizations can start by installing some form of internal supervision (e.g., an internal supervisory board and/or a compliance function). Internal supervisory bodies can also enhance awareness of their presence through the activities they perform. Especially for the compliance function, my research highlights the value of a multi-facetted compliance program of activities. If such a compliance program is not yet in place or limited in scope, organizations can start with implementing a program or extend the existing program, to include, for example, a code of conduct, policies, awareness training, and monitoring (Kaptein, 2015).

Furthermore, my results indicate that internal supervisory bodies are perceived to have high levels of power over decisions of middle managers and employees, but the source of power (position or personal based) differs per supervisory body. In an ideal situation, internal supervisory bodies would be able to use both power sources in order to select and tailor their use to what the situation requires, because in this way they can benefit from both power sources' short- and long-term effects on decision making (Deci, Koestner, & Ryan, 1999; French & Raven, 2001). However, internal supervisory bodies can best assess what is realistically possible in their situation, and focus on the power source that is available to them.

Finally, in relation to the composition of the internal supervisory board, my research indicates that it is important to have a frequent influx of new directors and thereby maintain a certain degree of diversity of tenure within the board composition. Such an influx will prevent interpersonal tensions with TMTs, as it stimulates supervisory boards to periodically reflect on their group values and to keep an open mind in this respect (Brewer, 2001). Organizations for their part, can assess the current tenure distribution and sequence of planned successions for the internal supervisory board. Based on this assessment, those responsible can consider to put a maximum on director tenure or implement a sequenced rotation of directors to maintain a periodic entry of new members (Johnson et al., 2013; Vafeas, 2003).

With regard to *external supervision*, my research also provides practical guidance for these supervisory bodies and the focus of their activities. My results indicate that the presence of external supervisory bodies is not directly related to the decisions of middle managers and employees, and these bodies are perceived to have less power than was expected. Instead, my findings of Chapter 4 indicate that external supervisory bodies could have an important influence when they monitor TMT decisions. Furthermore, this chapter also suggests that external supervision can have a mitigating role when conflicts arise between boards and TMTs. In this situation, external supervisory bodies, as part of the risk assessment mentioned in Chapter 1 (Financial Stability Board, 2014; Group of Thirty, 2015), could more pro-actively monitor whether there are signals of tensions in the dynamics between internal supervisory boards and TMTs, in order to prevent their consequences for TMT decision making (Sparrow, 2008).

The above insights together also provide feedback on the optimal *relationship* between both supervisory bodies. My findings suggest that it is important for external supervisory bodies to build a complementary relationship with internal supervisory bodies. This type of interaction would provide room for internal supervisory bodies to use their potential influence and available power to effectively impact decisions of organization members, while external supervisory bodies can strengthen the effectiveness of internal supervision and intervene when necessary. Such a complementary relationship does imply that when internal supervision is effective, external supervisory bodies can prevent crowding out of internal supervision's influence by refraining from independent and parallel actions on areas that are the primary mandate of internal supervisory bodies (Frey & Jegen, 2001). When internal supervision is ineffective, however, external supervisory bodies can take a more active role and intervene to address the weaknesses of the respective internal supervisory body (Jehn & Bendersky, 2003). For example, by assessing or changing the composition of the internal supervisory board to introduce more newcomers (Adams & Ferreira, 2012), and by diminishing the strain that Board-TMT conflict may put on TMT decision making through facilitating a dialogue between boards and TMTs (e.g., Karambayya, Brett, & Lythe, 1992).

Concluding Remarks

The emission-scandal and the financial crisis described in Chapter 1 illustrated how important effective internal and external supervision are to protect societal interests. My dissertation highlights that achieving such supervisory effectiveness is a balancing act, as the effectiveness of internal and external supervision is often interrelated, and depends on the social processes and structural governance factors in organizations and teams. My findings echo the quote from Goethe (1833, Maxim 353) in Chapter 1 about the most effective governance being “that which teaches us to govern ourselves”. As I find that internal supervision from within the organization has a stronger influence on organizational decisions than external supervision as an outside force. Therefore, I argue that external supervision can strengthen and complement internal supervision to use its potential influence more effectively. This makes me conclude that both supervisory bodies are important in their own right, yet they could govern themselves more effectively, and reinforce each other in their different roles to safeguard sound decision making in organizations.

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SUMMARY

Inleiding

Effectief intern en extern toezicht zijn beide essentieel om zorgvuldige besluitvorming binnen organisaties te waarborgen, zodat de organisatie- en maatschappelijke belangen worden beschermd. De noodzaak van, en de aandacht voor, effectief intern en extern toezicht zijn nog eens versterkt door de recente emissieschandalen in de auto-industrie, bijvoorbeeld bij Volkswagen, en eerder ook door de financiële crisis. In 2015 kwam aan het licht dat Volkswagen software gebruikte om te verhullen dat de uitstoot van schadelijke gassen (stikstofoxide) door haar ogenschijnlijk 'schone' dieselauto's hoger was dan volgens de regels was toegestaan. Uit dit voorbeeld blijkt dat de drie hoofdverantwoordelijke partijen, te weten het Top Management Team (TMT; Raad van Bestuur), bestaande uit de bestuurders waarbij de strategische besluitvorming was belegd, en zowel het interne als het externe toezichthoudende orgaan dat die besluitvorming had moeten controleren, hun verantwoordelijkheden niet of slechts gedeeltelijk hebben uitgevoerd. Tijdens de financiële crisis (2007-2009), een gebeurtenis die zowel de hele financiële sector als de maatschappij schokte, openbaarden zich soortgelijke problemen. Hiervoor wordt ook het falen van de corporate governance als een van de voornaamste oorzaken genoemd, voornamelijk het niet-effectieve functioneren van en de moeizame verhouding tussen Top Management Teams en de interne en externe toezichthoudende organen.

Een dergelijk falen van interne en externe toezichthoudende organen is een groot probleem voor de maatschappij, aangezien zij erop moet kunnen vertrouwen dat deze organen de zorgvuldigheid van de besluitvorming van organisaties effectief bewaken en de daarmee gemoeide langetermijnbelangen van alle relevante belanghebbenden - waaronder ook de maatschappij - beschermen. Interne toezichthoudende organen worden formeel door de organisatie zelf ingesteld om in de gaten te houden dat de besluitvorming het belang van de organisatie en al haar stakeholders dient. Voorbeelden van deze organen zijn de Raad van Commissarissen (RvC) en de compliance functie. Externe toezichthoudende organen zijn door de overheid ingestelde instanties, zoals inspectoraten (bijvoorbeeld de Belastingdienst) en onafhankelijke markt autoriteiten (bijvoorbeeld toezichthouders op de financiële sector). Deze externe toezichthoudende organen controleren of de besluitvorming van organisaties voldoet aan wet- en regelgeving en het maatschappelijke belang waarborgt. De bovengenoemde voorbeelden, het emissie-schandaal en de financiële crisis, roepen de vraag op: wat maakt elk toezichthoudend orgaan afzonderlijk en in combinatie effectief in relatie tot besluitvorming in organisaties? Deze vraag staat centraal in dit proefschrift.

Dit proefschrift is het resultaat van een gezamenlijk onderzoeksproject van De Nederlandsche Bank (DNB) en de Rijksuniversiteit Groningen. Vanwege deze combinatie vormt de Nederlandse financiële sector het specifieke kader voor mijn onderzoek en hierdoor heb ik voornamelijk financiële ondernemingen onderzocht waar sprake is van een dualistisch (‘two-tier’) bestuursmodel. In Nederland is een dergelijk bestuursmodel het meest gebruikelijk en op grond van de Wet financieel toezicht (Wft) zelfs verplicht voor veel financiële ondernemingen. In dit model is sprake van een Raad van Bestuur, oftewel het Top Management Team, als uitvoerend orgaan, en een Raad van Commissarissen, als toezichthoudend orgaan, die formeel structureel van elkaar gescheiden zijn. Aangezien de verdeling van werkzaamheden van uitvoerende en toezichthoudende bestuursleden in een monistisch (‘one-tier’) bestuursmodel vergelijkbaar zijn met die in een dualistisch model, verwacht ik dat mijn onderzoek ook in grote mate van toepassing is op organisaties met een dergelijk bestuursmodel.

De bestaande corporate governance literatuur biedt waardevolle inzichten in de effecten die interne en externe toezichthoudende organen afzonderlijk van elkaar hebben op de financiële prestaties van organisaties als geheel. De theoretische en empirische kennis omtrent de afzonderlijke én de gecombineerde effecten van beide vormen van toezicht op de daadwerkelijke besluitvorming door Top Management Teams, middenmanagers en werknemers is vooralsnog echter beperkt. Mijn proefschrift beoogt bij te dragen aan de volgende lacunes in de huidige literatuur: 1) de invloed van intern en extern toezicht op de besluitvorming binnen organisaties, zowel afzonderlijk als in onderlinge samenhang; 2) de invloed van intern toezicht uitgevoerd door de compliance functie, in combinatie met contextuele factoren, zoals de organisatiewaarden, op de besluitvorming door werknemers; en 3) het verband tussen intern toezicht door de RvC, structurele governance-factoren zoals de samenstelling van de RvC, en gedragsmatige groepsprocessen zoals conflict met besluitvorming door het TMT. In de 3 empirische hoofdstukken draag ik hieraan bij door te onderzoeken hoe, waarom, en wanneer intern en extern toezicht, afzonderlijk en in combinatie, de besluitvorming door Top Management Teams, middenmanagers en werknemers beïnvloeden. De belangrijkste uitkomsten bespreek ik hieronder per hoofdstuk, met ieder hun respectievelijke focus op deze verschillende groepen in organisaties.

De afzonderlijke en gecombineerde invloed van intern en extern toezicht

In hoofdstuk 2 onderzoek ik wat de afzonderlijke en gecombineerde invloed van intern en extern toezicht is op de besluitvorming door middenmanagers en werknemers. Ook bestudeer ik of de mate en soorten van macht waar deze organen over beschikken hun invloed kunnen verklaren. Ik verwacht dat interne toezichthoudende organen een sterkere invloed hebben op de beslissingen van organisatieleden dan externe toezichthoudende organen, vanwege de hogere mate van macht waarover ze beschikken in de ogen van deze organisatieleden. In dit hoofdstuk beargumenteer ik in het bijzonder dat deze interne toezichthoudende organen meer macht wordt toegedicht, op basis van zowel hun formele positie als de persoonskenmerken van de betreffende toezichthouders. Deze toegedichte macht wordt bepaald door de toegang die dergelijke organen hebben tot belangrijke organisatiemiddelen en hun mogelijkheden tot interactie en het opbouwen van relaties met organisatieleden. Tot slot onderzoek ik of de gecombineerde aanwezigheid van beide toezichthoudende organen meerwaarde heeft in relatie tot besluitvorming van middenmanagers en werknemers.

Ik heb deze veronderstellingen getoetst aan de hand van verschillende onderzoeksmethodes, waarbij ik een veldstudie onder 418 middenmanagers en werknemers heb gecombineerd met een experimentele scenario-studie onder 62 financiële middenmanagers. Uit de uitkomsten tezamen komt naar voren dat er inderdaad een sterker verband is tussen de enkele aanwezigheid van interne toezichthoudende organen en de besluitvorming door middenmanagers en werknemers dan de enkele aanwezigheid van externe toezichthoudende organen. Zoals verwacht wordt dit sterkere verband verklaard door de hogere gepercipieerde mate van macht van interne toezichthoudende organen in vergelijking met die van externe toezichthoudende organen. Echter, dit komt voornamelijk door de macht die deze organen ontlenen aan hun formele positie, en niet zozeer aan hun persoonskenmerken. Verder laten de resultaten zien dat de gecombineerde aanwezigheid van *beide* toezichthoudende organen geen automatische meerwaarde heeft, aangezien organisatieleden voornamelijk op de aanwezigheid van interne toezichthoudende organen reageren.

Intern toezicht en de rol van organisatiewaarden

In hoofdstuk 3 onderzoek ik de invloed van intern toezicht door de compliance functie en haar activiteiten (compliance programma's) in samenhang met de aanwezigheid van organisatiewaarden, in relatie tot de besluitvorming door werknemers. Ik verwacht dat de aanwezigheid van compliance programma's en organisatiewaarden beide verband houden met zorgvuldige besluitvorming door werknemers, en ik onderzoek of hun gezamenlijke aanwezigheid een sterker effect heeft. Ik verwacht dat deze effecten zich voordoen doordat zowel compliance programma's als organisatiewaarden het signaal afgeven dat de compliance officers macht hebben over het gedrag van werknemers, en dat deze macht aan verschillende bronnen kan worden ontleend. In dit verband beargumenteer ik dat compliance programma's kunnen signaleren dat compliance officers macht hebben op basis van hun functie, omdat ze door middel van deze programma's naleving van de regels controleren en indien nodig bestraffen. Organisatiewaarden, op hun beurt, kunnen het signaal afgeven dat compliance officers macht hebben op basis van hun persoonskenmerken, doordat ze die inzetten om informele ondersteuning te geven aan werknemers om zo de geldende sociale normen te helpen begrijpen.

Ik heb deze veronderstellingen getoetst in een veldstudie onder 78 compliance officers. De resultaten laten zien dat zowel de aanwezigheid van compliance programma's als die van organisatiewaarden invloed hebben op de besluitvorming door werknemers, maar dat hun combinatie geen grotere invloed heeft. Daarnaast blijkt dat het verband tussen de organisatiewaarden en besluitvorming door werknemers wordt verklaard door de macht van compliance officers op grond van hun persoonskenmerken. Tegelijkertijd wordt het verband tussen formele compliance programma's en besluitvorming niet verklaard door de macht van compliance officers op grond van hun formele functie.

Intern en extern toezicht en de rol van de structurele samenstelling van de RvC en RvC-TMT-conflict

In hoofdstuk 4 onderzoek ik het verband tussen enerzijds intern toezicht en de samenstelling van de RvC als structurele governance-factor, alsmede met conflict als onderliggend gedragsmatig groepsproces, en anderzijds besluitvorming door het TMT, in relatie tot extern toezicht. In dit hoofdstuk beargumenteer ik dat intern toezicht kan leiden tot een conflict tussen de RvC en het TMT (RvC-TMT-conflict), maar dat er minder kans op een dergelijk conflict is wanneer de structurele samenstelling van de RvC ook nieuwe leden bevat die recentelijk zijn toegetreden. Bovendien verwacht ik dat een dergelijk conflict de besluitvorming door het TMT kan schaden, en dat onder die omstandigheden het externe toezicht kan ingrijpen door hun toezicht te intensiveren en op die manier de negatieve uitwerking van een dergelijk conflict kan voorkomen.

Deze veronderstellingen heb ik getoetst in een veldstudie onder 111 TMT-leden en 152 RvC-leden van 56 verzekeringsmaatschappijen. Uit de uitkomsten blijkt dat intensief intern toezicht inderdaad kan leiden tot een conflict tussen de RvC en het TMT, maar dat dit minder vaak het geval is wanneer een TMT onder toezicht staat van een RvC met nieuwe leden die recent waren toegetreden. Als een dergelijk conflict zich wel voordoet, dan is de negatieve impact hiervan op de besluitvorming van TMTs minder sterk wanneer het externe toezicht verhoogd is door actief op te treden.

Conclusie en bijdrage aan theorie en praktijk

Mijn proefschrift geeft aan dat het bereiken van effectief toezicht een balanceer act is. Uit mijn onderzoek blijkt namelijk dat de effectiviteit van intern en extern toezicht met elkaar samenhangt, en mede wordt bepaald door de groepsprocessen en structurele governance-factoren die een rol spelen binnen organisaties en teams. De bevindingen laten zien dat intern toezicht een sterkere invloed en meer macht heeft in relatie tot de besluitvorming binnen een organisatie dan extern toezicht. Voor de effectiviteit van extern toezicht lijkt het dus vooral van belang om een complementaire relatie op te bouwen met het interne toezicht. Dit betekent dat het externe toezicht zich enerzijds richt op het versterken van het interne toezicht, zodat die haar potentiële invloed effectief kan uitoefenen, en anderzijds actief optreedt op het moment dat intern toezicht niet voldoende effectief opereert.

Dit proefschrift integreert verschillende literatuurstromen binnen de disciplines van corporate governance, organisatiegedrag en sociale psychologie en levert daarmee een belangrijke bijdrage aan de literatuur over corporate governance. Deze aanpak was cruciaal om een diepgaander inzicht te verkrijgen in de verschillende dimensies van de effectiviteit van intern en extern toezicht, zowel afzonderlijk als in onderlinge samenhang. De resultaten van mijn onderzoek maken drie patronen zichtbaar die meer inzicht bieden in, 1) de invloed van intern en extern toezicht op de besluitvorming binnen organisaties, zowel afzonderlijk als in combinatie; 2) de psychologische mechanismen die deze invloed kunnen verklaren; en 3) de invloed van context factoren op deze relaties. Daarnaast geven deze bevindingen praktische inzichten voor organisaties, toezichthoudende organen en beleidsmakers om de effectiviteit van intern en extern toezicht te vergroten en hun onderlinge verhouding te optimaliseren, zodat deze organen elkaar vanuit hun verschillende rollen kunnen versterken om zorgvuldige besluitvorming te waarborgen.

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Ik heb een enorme fascinatie voor gedrag in organisaties en psychologie, en de drang om het ‘waarom’ achter dit gedrag te onderzoeken zat er al vroeg in. Deze interesse blijkt ook uit mijn uiteindelijke studiekeuze voor bedrijfskunde (al had dit ook zomaar de hotelschool kunnen zijn) en mijn verdere specialisaties in verandermanagement en Human Resource Management. Toen me werd gevraagd of ik wilde promoveren was ik snel om, helemaal toen het mogelijk was om dit te combineren met een baan bij De Nederlandsche Bank (DNB).

Het bleek, vanuit mijn optiek, ook nog eens te gaan om een unieke baan, als toezichthouder bij het expertisecentrum voor gedrag en cultuur bij DNB. De oprichting van dit expertisecentrum kwam voort uit inzichten door de financiële crisis, met als doel om meer preventief op te kunnen treden, voordat problemen zich voordoen. Dit betekende een verandering in het toezicht waardoor er, naast financiële cijfers en ratio’s, ook meer expliciete aandacht kwam voor risico’s op het gebied van governance, gedrag en cultuur, en de ontwikkeling van de benodigde expertise en methodologie voor de beoordeling hiervan. Ik voel me bevoorrecht dat ik hierdoor de mogelijkheid kreeg om bij DNB en het expertisecentrum te gaan werken, en zo onderdeel ben geworden van een eerste stroming gedragskundigen en sociaal psychologen in het toezicht. Ik heb de afgelopen jaren de aandacht voor governance, gedrag en cultuur enorm zien groeien, in de financiële sector en

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DNB bood me daarnaast de mogelijkheid om het werk van toezichthouder te combineren met het doen van wetenschappelijk onderzoek. Deze positie bij DNB is een grote inspiratie geweest voor mijn onderzoek naar de impact en verhouding van intern en extern toezicht, in relatie tot besluitvorming in organisaties. Dit bleek een relevant vraagstuk, vanuit de toezichtspraktijk in verschillende domeinen, en ook vanuit de theorie en wetenschap zijn hier nog veel vragen over te beantwoorden. Met dit proefschrift hoop ik aan beide een waardevolle bijdrage te leveren, mede door het genereren van praktische toepasbare inzichten die de effectiviteit van het interne en het externe toezicht, en hun relatie, verder kunnen vergroten. Het schrijven van een proefschrift naast een interessante en uitdagende baan is geen makkelijke opgave, wat in mijn geval daardoor misschien ook ‘iets’ langer heeft geduurd. Toch had ik het niet anders willen doen.

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Na de middelbare school, via de mavo/havo, ging ik bedrijfskunde studeren aan de RuG in het mooie Groningen, samen met Esther en Renske. Jullie begrepen er eigenlijk niets van dat ik na twee masterscripties ook nog wilde promoveren, maar dat deed niets af aan jullie steun tijdens dit hele traject. Dank jullie wel, voor al die gezellige momenten waarin we altijd enorm samen kunnen lachen ('altijd gezellie'!).

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Tot slot, als reflectie op dit bijzondere moment, mooie woorden die voor mij alles zeggen:

“Heel even nog heel even

Dan wordt wat helder is weer vaag

Alles kan nog

Alles kan nog

Alles kan nog vandaag”

(couplet uit: Alles kan nog, tekst H. van der Lubbe, 2013, p. 119, In: Schrijvers uit Oost, *Oost*, Amsterdam: Babel & Vos)